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The Province of Alberta

IN THE MATTER OF "THE NATURAL GAS UTILITIES ACT"

—and—

IN THE MATTER OF an Enquiry into Scheme to be adopted for Gathering, Processing and Transmission of Natural Gas in Turner Valley

---

G. M. BLACKSTOCK, Esq., K.C., *Chairman*

Dr. E. H. BOOMER, F.C.I.C., *Commissioner*

Session:

CALGARY, Alberta September 12th, 1945.

VOLUME 38.

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I N D E X

VOLUME 38

September 12th, 1945.

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9.30 A.M. Session,
September 12, 1945.

MEMORANDUM OF CORRECTIONS OF TRANSCRIPT

VOL. 31

Evidence of J. A. McCutchin.

Page	Line	Correction
2439	26	Delete the words "as the method"
2440	19	Delete the word "Now" and commence sentence "The N.G,A.A. and delete the word "the" occurring between the words "that and "tests"
	20	Delete word "the" occurring between word "that" and word "payment"
	22	Put comma after word "procedure".
	24	Change word "the" to "this" after word "Now and change "tests" to "testing".
	25	Delete words "tests usually" and change "result" to "results".
	26	Add after word "purposes" the words "than Plant Recovery".
	27	Change "is" at end of line to "are".
	28	Delete word "reach" and substitute words "the liquid flour from" and change word "in" to "into".
	30	Change "evaporation" to "vapor"
2441	2	Add word "what" after word "just" and add word "is" after the word "procedure" at end of line.
	11	Delete words "or alternately" and substitute words "here as under an M.6.A.A. contract", and change "in" to "In"
	12 & 13	Delete "as the g.p.m. test would indicate" and substitute the words "illustrates the point"
	13	Delete word "in" where it occurs between words "words" and "going" and substitute words "if one is"
	14	Change "must" to "will"
	19	Add word "here" between words "lean" and "that"
	20	After word "fuel" add words "on Leases" and change sentence "It does not pay to put it back" to "It does not pay to transport it back to Leases." and delete word "here" where it occurs between words "situation" and "is".
	21	Change word "this" to "the" and add between words "N.G.A.A." and "gas" the word "contract" and delete word "proposition"
2443	3	Add word "as" between words "than" and "similar"
	4	Delete word "them" and substitute words "N.6.A.A. Contracts"
	11	Change "Plant" to "use"
2446	6	Delete word "them" and substitute words "all gas wells"
2448	14	Delete words "got that" and substitute word "discussed"
	15	Delete words "have got inserted a provisions for B.A."and substitute "have inserted a clause defining B.A."
2449	14	Delete words "a little bit"
2450	27	Change"operations" to "deductions"
2451	5	Delete word "that" and substitute words"the Madison"

Page A.1.1. Section 1.
Section 1a, line 1.

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APPENDIX C. SUGGESTIONS OF REVISIONS

VOLUME I

Suggestions of U. A. Moodie

Page	Line	Suggestion
24	20	Delete the words "as a"
24	19	Delete the word "the" and change "Ministers" to "Ministry"
		"The U.A.A. and Ministry"
		Insert between the words "Ministry" and "Ministry"
20		Delete the word "and"
		Put the word "Ministry"
23		Put comma after "Ministry"
24		Change "and" to "their" after the word "Ministry"
		Delete "Water" in "Water"
25		Delete words "and to Ministry" and change "Ministry" to "Ministry"
26		Add a full stop "Prep/Ministry"
		Recovery"
27		Change ""
28		Delete ""
		Insert ""
29		Change "Ministry" to ""
24	2	Add word "Ministry" after "and"
		""
		""
		"

Page	Line	Corrections
2451	6	Change word "flare" to "flared"
	11 & 12	Delete words "There has been" and change "as" to "As" commencing new sentence.
	14	Change sentence "The reason for that, as we see it, is that the gas is mentioned in the first part of the submittal" to read "The reason for that, as we see it, is that flared gas is not suggested as a deduction in the first part of the submittal."
	16	Change sentence "That gas which is to be repressured gas, the gas which is flared, in flaring the gas is not available to repressuring, and that gas is not available to market." to read "We submit that gas which is flared should be deducted from repressured gas. The gas which is flared is not then available for repressuring, and liquid flared gas is not available to market".
	20	And the word "and" between the words "approach" and "which".
	22	Delete the words "one is" and substitute the word "are". Delete the word "of" where it occurs between the words "equipment" and "handling" and substitute the word "for" and delete the word "equipment" at the end of the line.
	23	Delete the word "for" the first word in the line and add the word "reason" between the words "other" and "being"
	25	Delete the word "for" where it occurs between the words "cured" and "enough" and substitute the words "by investing"
2452	2 & 3	Delete the words "adjusted to a uniform basis with all other gas cap allowables in the field".

VOL. 32

2457	25	Change the words "a necessary" to "necessarily a"
2458	25	Add the word "it" between the words "handle" and "of"
2460	7	Change the word "handle" to "repressure" and add after the word "gas" "cap allowables" and change the words "put in" to "return".
	8	Change word "into" to "to"
	11	Add the letters "B.A." between the words "the" and "gas"
	17	Delete the words "the specific purpose, for"
2461	17	Change the word "are" to "believe"
	22	Delete the words "from scratch"
2462	6	Delete the words "or are not"
	22	Change "We will immediately go out through the gas cap and give you all the gas that you want". to read "We will immediately go out and open up the gas with cap wells and give you all the gas that you want."
2467	25	Delete word "which" at end of line and substitute words "and non uniform rules"
2468	4	Delete words "any other body" and substitute "any one"
	15	Change "we had had" to "we have had"
2469	3	Delete the words "This came around"and substitute

Page	Line	Corrections
2469	3	"The Royalite Gas Cap sharing position was arrived at"
	7	Delete words "and you" and substitute "where gas wells other than Royalite's" and delete word "your" at end of line and substitute "the actual"
	8	Delete "You" and substitute "Others" and change the word "the" between the words "below" and "full" to "their"
	13	Change "but" to "and" at end of line.
2470	4	Delete the second "we"
	5	Add between the words "reasonable" and "that" the words "that it would prevail"
2472	6	Change "the Madison plan proposes handling the Gas Cap in this simple and easy proposition and handle the gas gathered on the one basis and they have run through a series of Tables here which are voluminous. If they could handle the Gas Cap Allowable of the Royalite Gas Cap, it just deals with the gas well allowable" to "the Madison plan for handling the Royalite Gas Cap is a simple and easily understood proposition and handle the gas gathered on one basis and, to illustrate, they have run through a series of Tables here which are voluminous. If they could handle the Gas Cap Allowable of the Royalite gas cap, other Gas Cap Allowables can be used in the same way."
	11	Add between the words "The" and allowable" the words "B.A. Gas Cap"
	18	Change "could" to "did"
	20	Delete the word "that" and substitute the word "principles"
	21	Delete the word "at" and substitute the word "as"
	24	Delete the word "great"
	25	Delete the words "to anybody .
2472	18	Change word "Depressuring"to "Recompression"
2475	10	Add between the word "be" and the word "there" the words "some waste"
	17	Delete the words "set up some" and substitute the word "install"
2476	5	Change second "that" to "rules"
	27	Add "a" between the words "approach" and "problem"
	28	Change words "do not" to "can only"
	30	Add the words "now at" between the words "is" and "the"
2477	15	Delete the word "it" and substitute the words "we submit ours"
	24	Delete the word "it" where it first appears in the line and substitute "we"
2478	10	Delete the word "either"
	24	Delete the words "or it might" and substitute the words "and it would".
2479	2	Add the word "can" between the words "we" and "put"
	15	Add the word "would" between the words "we" and "catch"
	23	Change "gas at the Bow Island" to "gas stored at Bow Island"
2480	3	Add the words "treated the same as gas" between the words "is" and "sold"
	4	Delete the words "the Valley Pipe Line"
	7	Delete the words "up until now" and add between the words "one" and "I" the words "volume of gas"

Page	Line	Corrections
2481	7	Delete the words "are having" and substitute "planned"
	8	Delete the words "all kinds of" and substitute "many"
2486	22	Add the word "operation" between the words "in" and "until"
2490	9	Change "pentane" to "butane"
	11	Change "pentanes" to "butanes"
	20	Change "pentane" to "butane"
	21	Change "get" to "contain" and "butane" to "pentane"
2491	10	Change "was" to "were"
	22	Change "a few" to "some"
2493	17	Delete the second "is" in the line.
2496	29	Change "us" to "use"
2503	10	Change "It has" to "The lines have"
2511	16	Change "schedule of time" to "scheduling of producting time"
	26	Add after the word "producers" and before the word "When" the word "settled"
2514	4	Change "in a day" to "some days"
	5	Change "in a day" to "the line some days"
	17	Delete word "it"
	18	Change "have to" to "must" and "some" to "the same"
	20	Change "it" to "that"
2515	1	Delete word "or" and substitute words "deducted from"
	2	Add after word "conserved" the word "gas"
2516	5	Change "the allowables to" to "We submit the allowables should"
	6	Change "Madison" to "Royalite Gas Cap"
	22	Delete the words "the rest of"
	26	After the word "available" and before the word "to" add the word "according"
2517	4	Change "have the" to "avoid a" and delete "the" and substitute "a"
	26	Delete the words "of the other gas"
2518	9	Delete word Over (second word) and after the word "run" delete "for", and after word "over" and before word "month" add "for one"
	10	Delete words "it does not mean" and after word "be" and before word "final" change "any" to "a"
	11	Change word "on" (last word in line) to "than"
	12	Change second word "share" to "sharing"; add after the word "same" and before word "for" the words "sharing position" and delete "portion of the".
	13	Delete "is" after word "it" and before word "by" and substitute words "has to be exact".
	14	Change "a" to "an", delete word "keel" and substitute words "basis or adjusted"
	30	Change "in" to "over"
2520	20	Add word "know" at end of line
	25	Change "of" to "or"
2521	6	Change "it" (second word) to "there"
	14	Change word "sell" to "deduct", delete words "to be" and delete word "out" after word "flared".
	16	Delete words "chains of"
2523	21	Delete the words "the No. 1 Royalite Plant, previously"
	27	Change the word "could" to "were" and after the word "actually" and before the word "deliver" add

Corrections

Page	Line	Corrections
2523	27	the words "needed to"
2524	5	Add the word "is" after the word "situation" and before the word "that"
	15	Delete word "at" (first word)
2525	16	Change "100" to "one", and add word "to" after word "million" and before word "one"
	18	Delete word "feet" (first word)
	24	Add word "back" after word "pounds" and before word "pressure"
2526	12	Change "has" to "is" (second word)

RALPH DENNISON BAKER, having been first duly sworn, Examined by Mr. Chambers, testified as follows:

Q Mr. Baker you are, as I understand it, the General Manager of James Richardson & Sons, is that right ?

A That is right.

Q Now the chief place of business of James Richardson & Sons is, as I understand it, the City of Winnipeg ?

A That is right.

Q And that firm was, as you have already informed me, was organized as I understand it in 1857 at Kingston, Ontario ?

A Yes.

MR. CHAMBERS: I am leading the witness because I thought it would save time.

Q MR. CHAMBERS: And at the time of the organization they were engaged in the business of Grain Merchants, originally ?

A That is right.

Q And at the present time they carry on the business of Investment Dealers ?

A That is right.

Q They are members of all leading Stock Exchanges across Canada ?

A That is right.

Q At Montreal, Toronto, Winnipeg, Calgary, Vancouver ?

A That is right.

Q Are there any others ?

A No.

Q And they are also members of the Investment Dealers Association of Canada ?

A That is right.

Q Is James Richardson & Sons Limited, - are they themselves actively engaged or concerned with the Public Utility business ?

A No.

Q As I understand it since 1926 or thereabouts your firm maintained a private wire system serving the West in connection with securities and investments ?

A That is right.

Q Now then let us turn for a moment to your own experience; prior to the last war you were engaged in business in Winnipeg, is that right ?

A That is right.

Q With whom were you then ?

A The North British Canadian Investment Company, the Scottish-Ontario and Manitoba Loan Company and the Real Estate Loan Company of Canada.

Q They were all allied Companies ?

A Yes.

Q And the main nature of the business of those Companies was real estate investments?

A Real estate investmentsand mortgages.

Q And from 1914 to 1918 you were in the first Great War yourself ?

A That is right.

Q And then when you left the Service you went with whom ?

A The Equitable Life of New York.

Q And you were with them for a short time I understand ?

A Yes.

Q And when you left the Equitable Life where did you go or what was your business ?

A I went into the Investment business.

Q With what Company ?

A The Commercial Credit Company.

Q And what was the nature of their business ?

A Financing time sales.

Q And you were with them for about a couple of years ?

A About that, yes.

Q And then as I understand it you were in business for yourself in Winnipeg with - -

A John MacGregor.

Q What was the nature of that business ?

A Investment dealers.

Q And you carried on business yourself with Mr. MacGregor until about 1925, is that right ?

A That is right.

Q Then from there where did you go ?

A I went from there to E. A. Pearce & Company of New York.

Q Who are E. A. Pearce & Company ?

A They are members of the New York Stock Exchange.

Q And they deal in the investment business, stocks and bonds ?

A Yes.

Q And what position did you occupy with them ?

A Manager of the Winnipeg Western Canadian business.

Q And you were in that position until 1927 when what happened ?

A James Richardson & Sons Limited took over from earce, took over their Western Canadian and Winnipeg office.

Q And then you carried on with James Richardson & Sons Limited ?

A That is right.

Q And you are now, as you said, the General Manager of James Richardson & Sons Limited ?

A That is right.

Q As I understand it you yourself were President of the Investment Dealers Association of Canada back in 1936 and 1937 ?

A That is right.

Q And you also have been Vice President twice of that organization, of the Western section ?

A That is right.

Q Which takes in the three prairie Provinces ?

A Yes.

Q And you have also, as I understand it, been President on various occasions of the Winnipeg Stock Exchange ?

A That is right.

Q Now I understand, Mr. Baker, you have been actively connected with the various War Loans in Canada, will you just tell the Board very briefly what your connection has been and what positions you have occupied ?

A Well since 1939 I have been connected with the Bank of Canada, a Member of the Dominion Executive of the National War Finance Committee, and Vice President and Executive Vice President for the Province of Manitoba since 1941 when the National War Finance Committee was formed.

Q Well now Mr. Baker, you have, as I understand it, prepared, first of all at the request of the Madison Company, a report entitled:

> "Submission to the Natural Gas Utilities Board in respect to Fair Rate of Return on Rate Base of Madison Natural Gas Company Limited",

that is correct ?

A That is right.

Q You have that report with you ?

A Yes.

MR. CHAMBERS: We have the original and probably it should be marked. Have you the original there, Mr. Baker, the original copy which you signed ?

A No, I gave that to you. I have one here. You mean on our own letter head ?

Q Yes.

MR. CHAMBERS: The Board can probably have this one marked in the meantime.

THE CHAIRMAN: Yes.

SUBMISSION PRODUCED BY MR. BAKER HERE MARKED AS EXHIBIT 106.

Q MR. CHAMBERS: Now Mr. Baker, will you please read the report and as you go along, if there are any comments or explanations you want to make on your own, feel perfectly free to do so.

A Mr. Chairman, this report is dated August 1st, 1945 and known as:

Submission to the Natural Gas Utilities Board in respect to Fair Rate of Return on Rate Base of Madison Natural Gas Company Limited.

Definition -

"The duty of the Board was to fix fair and reasonable rates; rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested. By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities possessing an attractiveness, stability and certainty equal to that of the company's enterprise."

The authority for that definition is The Supreme Court of Canada - 1929 S. C. R. 192-3.

I submit that a return of not less than 9½% is just and equitable, all circumstances considered.

The Circumstances -

(a) The investment is made and has to remain for the life of the project.

The Company has nothing to gain by way of capital appreciation and only has a preferred position when considering capital protection with funds anchored to a single purpose.

(b) Funds frozen -

Conversion to alternate ventures impossible.

Once the investment is made the owner has no option but to stay with commitment until the end, because if conditions are indicated which will make the holder anxious to sell, such would also deter a buyer.

(c) Funds of no value as capital asset -

Of no collateral value.

With the project dependent upon revenues which will be less and less as time goes on, no one is willing to advance money against a security which is diminishing. For example, should the proprietors desire to raise capital for similar or other operations, the nature of these assets does not permit of new financing as they cannot be used as collateral or pledged for other purposes. Funds other than those being made available by fixed depreciation arrangements available to the proprietor cannot be said to be controlled by the proprietor.

(d) Considerable risk involved -

Capital loss possible.

Should the field peter out ahead of the estimated life, or adjacent fields as close or closer to Calgary develop such

as Jumping Pound, a new and cheaper fuel developed, or social changes result in a shift in population, this company would lose justification for its continued operation.

(e) Original venturesome aspects eliminated - Shareholders return disproportionate to risk involved. In view of the factors as outlined in clause (d), the proprietors are precluded from utilizing the benefits of good management or business ingenuity in any case whereby they might assert their normal influence and use the funds elsewhere in reasonable anticipation of earning not less than 9%, this being the average for a number of Canadian companies as per example shown below.

In order to attract capital to an enterprise such as this, the minimum net return should equal that obtained in other industrial ventures and for this reason a minimum net return of 9% would have to be obtainable.

Example -

In January of this year, the Bank of Canada released financial statistics covering 678 Canadian companies and for the year 1943 reported that net income to stockholders (including refundable Excess Profits Tax) amounted to $294,000,000 which was obtained on an investment of $3,251,000,000 represented by net capital and surplus - the total capital and surplus of these companies at that time amounted to $4,221,000,000 but of course, there should be deducted from this amount, funded debt, advances from Government, and loans from parent and other companies, as interest on these items had already been deducted in arriving at the net income figure referred to and these various deductions

amounted to $970,000,000 thus leaving the foregoing figure of $3,251,000,000. Accordingly the percentage return on the foregoing capital base of $3,251,000,000 was 9.04%.

In the United States the National City Bank of New York in April of this year in their monthly letter stated that the aggregate net income of a group of 2,665 leading corporations in 1943 was approximately $5,266,000,000 which represented an average return of 8.6% on a net worth of $61,414,000,000.

(Go to Page 2895)

Conclusion -

Therefore to obtain a net return comparable to Canadian industry as a whole, a minimum of 9% would have to be available and when consideration is given to the additional risk entailed in this particular enterprise, such as those possibilities mentioned under (d) and (e) of "Circumstances" an additional one-half of 1% return is by no means excessive and thus justifies a 9½% rate which is further borne out by "Supplement" below.

Supplement -

Gas utility rates in the United States as announced in a recent decision allow a return of 6½% to the operator and even this rate is not considered sufficient for owners in that area, as for example the following item from the business section of "Time" of May 14th, 1945, reveals:

"This would automatically give FPC a big voice in the Chicago Corp.'s affairs. More important, it would limit much of the profits from the corporation's chance-taking to 6½%, not enough to make it worth while to go on taking long chances.

So last week Chicago Corp. put through a deal of Tennessee Gas to raise $42,750,000 by issuing bonds and preferred stock on the pipeline, get another $15,000,000 in bank loans. With the money, Tennessee Gas will pay off the loans of the RFC and the Chicago Corp. Now, if the FPC decides that Chicago Corp. is a natural gas company, it will simply get rid of the pipeline either by (1) selling it outright or (2) giving it to the stockholders."

Therefore, the 9½% rate to Canadian operators is more than reasonable when you consider such financing and earning factors as the following:

Canada

The Eighth Victory Loan is dated May 1st, 1945, and will mature on October 1st, 1963. The issue price is 100 and the coupon rate is 3%. Therefore, the interest rate for the highest grade Dominion of Canada security is 3%.

United States

The Seventh War Loan is dated June 1st, 1945, and consists of three different maturities, of which the one which corresponds the closest to the Canadian issue from the viewpoint of maturity is the 2¼% bonds due June 15th, 1962. The issue price is 100 and the coupon rate is 2¼%.

Thus, the return obtainable here in Canada on the soundest security is 1/3 higher than that of the United States. Therefore, from the viewpoint of financing a Government bond issue alone, the cost is 1/3 higher here in Canada, and carrying this ratio into the gas utility rate decision in the United States would justify a minimum return in Canada of 8-2/3%.

This 8.66% still leaves .84% to be accounted for to arrive at the 9½% rate which we have submitted as just and equitable. In connection with this .84% additional return, we would point out that a gas utility operation is subject to usual hazards as well as those specifically applicable to this type of operation.

Thus, when you consider that representative Canadian industry obtained a 9.04% return compared with a return of 8.6% by representative American companies, which is a percentage difference of about 5% and applying this ratio to a gas

utility rate decision would justify a further adjustment of .325% (5% of 6.5) which would bring the total comparative rate, based on the foregoing factors up to 8.985% here in Canada.

This would leave only .515% as additional compensation and recognition of conditions peculiar to this single operation such as the fact that it is an isolated Canadian operation which is dependent upon one field and one market, while in the United States the gas utilities tie in and are dependent upon a number of different fields and multiple markets so that the risk is not nearly as great as there is in this single operation as outlined under "Circumstances" (d) and (e).

SUMMARIZATION

Consequently I reiterate, and as shown in the foregoing, that a minimum return of 9½% is only just and equitable.

Therefore, I recommend, all factors considered, that a return of 9½% be the absolute minimum in order to secure to the Company a fair return on the capital invested.

JAMES RICHARDSON & SONS,

Ralph D. Baker,

General Manager.

Q MR. CHAMBERS: Mr. Baker, you said 9½% net. As I take it you mean after payment of all income taxes by the Company. Is that right ?

A That is right.

Q In your Report Exhibit 106 which you have just read, you refer to the Bank of Canada and the National City Bank of New York ?

A Yes.

Q You have printed copies of those reports ?

A Yes I have.

Q And if the Board pleases those are the reports I have circulated and I suggest they be marked as Exhibits 107 and 108.

STATISTICAL SUMMARY BANK OF CANADA NOW MARKED AS EXHIBIT 107.

DOCUMENT REFERRED TO AS NATIONAL CITY BANK OF NEW YORK, REPORT DATED APRIL 1945, NOW MARKED AS EXHIBIT 108.

Q Would you turn, Mr. Baker, to the Bank of Canada Report, Exhibit 107 and indicate to us how you arrive at the example you have used in your Exhibit 106, Page 11, as I understand it.

A On Page 11, taking the first figures 294, middle figures do not matter, because they are the deductions I referred to. You will see all the figures I refer to on Page 11.

Q By the way I understand that in order that you may be absolutely clear in your own mind as to the deductions that you came to that the return was a net return after payment of income taxes, you took the opportunity to communicate with Mr. Towers of the Bank of Canada ?

A That is right.

Q And you got a letter from him ?

A That is right.

Q And I have copies of that letter and I would like to put the original in. Have you the original letter ?

A Yes, I have.

Q I am going to tender this as an Exhibit and I will read it first. It is a letter dated August 30th, 1945 to T. J. Norquay, Esq., James Richardson & Sons, 367 Main Street, Winnipeg, Manitoba.

Dear Sir,-

In the absence of Mr. Beattie I have been asked to reply to your letter of August 28th.

You are correct in assuming that the figure of $294 mm. is the net income to stockholders after depreciation and all operating and tax deductions. I am enclosing an off-print of a survey of profit statistics published in our Aug.-Sept. 1944 Summary which shows in detail the deductions made before arriving at net income to stockholders. Yours sincerely, W. E. Scott, Banking Assistant.

DOCUMENT NOW READ MARKED AS EXHIBIT 109.

I gave the Board two copies.

Q Are there any other observations you want to make ?

MR. BLANCHARD: That will be attached to the Exhibit.

THE CHAIRMAN: No I am putting it in as 109, Mr. Blanchard.

MR. CHAMBERS: Exhibit 109.

Q And Mr. Baker, would you indicate on the National City Bank Report which is Exhibit 108 where you drew the conclusions that you show in your own Report Page 39, is that it ?

A On Page 39, paragraphs 1, 2, 3 and 4.

Q And then the summary at the bottom ?

A And the summary at the bottom of column 1, page 39.

Q Then Mr. Baker, you were asked to prepare another report on behalf of or for Royalite entitled "Submission to the Natural Gas Utilities Board in Respect of Discount Rate on Field Purchases by Royalite Oil Company Limited of Gas to be Conserved or Repressured" ?

A Yes, that is right.

Q And you have that report ?

A I have it.

Q Would that be marked as Exhibit 110.

DOCUMENT NOW REFERRED TO ABOVE MARKED AS EXHIBIT 110.

Q Would you read that report Mr. Baker and make any comment you see fit to make as you go along ?

A Mr. Chairman and the Board, -

August 1st, 1945.

SUBMISSION TO THE NATURAL GAS UTILITIES BOARD IN RESPECT OF DISCOUNT RATE ON FIELD PURCHASES BY ROYALITE OIL COMPANY LIMITED OF GAS TO BE CONSERVED OR REPRESSURED.

The problem concerning a fair rate of discount on field purchases of gas is analogous to a Bank acting in the dual capacity of purchasing agent and custodian for the consumer.

As purchasing agent, the Bank agrees to furnish funds as may be required to pay the producer the market price at well head less 8% discount for a period of fifteen years.

As custodian, the Bank is prepared to receive deposits of gas for safekeeping and hold in trust for delivery to the consumer when required upon payment of the face amount of the original loan.

For services, as custodian, the Bank shall be reimbursed all expenses in effecting a lodgement of the gas to be deposited.

It is our contention that the position of the Royalite Company and its functions in its proposed undertaking is no different to that of the Bank as outlined in the preceding paragraphs.

Royalite Company in agreeing to finance the consumer at a discount of 8% over a period of fifteen years is using funds from day to day which might otherwise be used at a rate in excess of 9%. (9.04% as per example to follow.) Were these funds to be employed at the same rate of 9.04% the Royalite

[illegible]

[illegible]

- [illegible] -

[illegible]

[illegible]

[illegible]

Company would be entitled to a premium of 15% at maturity.

In other words, the Royalite Company is advancing .63¢ -

Q MR. CHAMBERS: That should be sixty-three hundredths cents. .63¢. You said sixty-three cents.

A .63¢ yes.

. 63¢ for each thousand cubic feet purchased on behalf of the consumer and will receive from the consumer at maturity 2¢ per thousand cubic feet (or such other price as may in like manner result from any other present price fixed by the Board).

On the other hand, however, if the company were to invest .63¢ compounded yearly at 9.04%, it would receive 2.30¢, the equivalent of 15% premium at maturity.

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It is, therefore, submitted that the proposed 8% discount is a fair charge for financing of this description and it is also submitted that to reimburse the company as custodians, all lodgement fees should be borne by the consumer when the gas is initially deposited.

EXAMPLE:

In January of this year, the Bank of Canada released financial statistics covering 678 Canadian companies and for the year 1943 reported that net income to stockholders (including refundable Excess Profits Tax) amounted to $294,000,000 which was obtained on an investment of $3,251,000,000 represented by net capital and surplus. Accordingly, the percentage return on the foregoing capital base of $3,251,000,000 was 9.04%.

Q MR. CHAMBERS: Mr. Baker, reverting for a moment to Exhibit 106, your first report, and I note that you open with the definition, just in order that the matter may be cleared for the record, in giving you instructions or asking you to give or prepare your opinion as to what the fair rate of return would be, I, myself, referred you to that as a criterion that you could take as a basis that you should work on?

A That is right.

Q And your contention is that your report is your judgment in the light of that definition as to what the net rate of return should be?

A Just say that again.

Q For the reasons that you have indicated in your report and applying the tests in that definition, you have come to the conclusion that the 9½% net return is what should be allowed?

A Yes, that is right.

Q That is all, Mr. Baker.

THE CHAIRMAN: Mr. Fenerty?

MR. FENERTY: If the Board pleases, some of the points that I intend to go into have been considered at more length and more effectively by Mr. Blanchard, so that if I may defer my cross-examination, and it may save a lot of time for all concerned, and it may perhaps be eliminated after altogether.

THE CHAIRMAN: Mr. Steer?

MR. STEER: I have no questions at the moment.

THE CHAIRMAN: Mr. Harvie?

MR. HARVIE: I feel the same way as Mr.Fenerty, that possibly Mr. Blanchard will cover the cross-examination to some extent and if I go on there might be duplication. I might have some point after.

THE CHAIRMAN: Mr. McDonald?

MR. McDONALD: I concur.

THE CHAIRMAN: All right. Mr. Blanchard, you have the floor.

MR. BLANCHARD: I suppose there is no one left that I can pass it on to.

THE CHAIRMAN: Perhaps Dr. Boomer might?

.....

CROSS-EXAMINATION BY MR.BLANCHARD.

Q Mr. Baker, I would like to deal first with your last exhibit, Exhibit 110, that is the submissions relating to the purchase of gas by Royalite, the purchase of repressured gas by Royalite. Now there is one thing that strikes me as extremely important

in this particular submission, and that is where you say on page 2 in the third paragraph, "It is, therefore, submitted that the proposed 8% discount is a fair charge for financing of this description and it is only submitted".....

MR. CHAMBERS: Also.

MR.BLANCHARD: "Also submitted" I beg your pardon, "that to reimburse the Company as custodians, all lodgement fees should be borne by the consumer when the gas is initially deposited." Now are we to assume that you have been instructed in preparing this submission that the consumer is going to bear those lodgement fees, is that implicit in the offer of the Royalite Company?

A Well I have not been instructed, and whether it is implicit as far as the Company is concerned I do not know.

Q You do not know?

A No.

Q You have assumed that though?

A Well the only reason I assumed that, Sir, is this, that I am speaking there of 8% clear, of 8% net, in order to get those securities, and by securities I am referring that like to a bank. I am thinking of oil or gas, in this case gas, and to get that 8% after the lodgement is completed, then it occurred to me that those fees should be paid by someone.

Q Someone?

A Yes.

Q Yes, someone. Now if they have to be paid by Royalite.....

A Oh no.

Q Just a minute. If they have to be paid by Royalite then I assume that they would not buy gas at that price, at the price that they offer to pay at. Do you know anything about that?

A No, I do not know anything about that.

Q And if they have to be paid by the producer, possibly the producer would not be willing to sell at that price?

A Would the Company receive 8% net if they had to pay those fees? I would assume that the consumer would have to pay that to justify the point I am making of 8% net to the company.

Q Yes. At this point, Mr. Chairman, I think that Counsel in this case and this Board are going to be faced with a very important problem. It does appear to me that the proposal of Royalite and its acceptance, as I understand it, by the producers, of whom Royalite is one of the main producers, is all based on the assumption that someone other than Royalite or the producers are going to bear the cost of transportation and repressuring of that gas.

Now then, the only reason I bring this subject up at this point, and it occurs to me as a result of asking this question, is this, that it seems to me that none of us, as Counsel, can assume that this burden is to rest on the ultimate consumer, and there should be before this Board some alternative proposal in case it transpires that the Board says, "Well, the producers and the Royalite must bear the cost of this transportation, and not the Gas Company or the ultimate consumer." Otherwise it seems to me that we are going to go through this hearing and just at the last moment if the Board intimates that this burden is not to be placed on the ultimate consumer, the producer will say "We won't sell at 2 cents discount", or whatever it might be, and Royalite says "We won't buy it." And it seems to me that we should all be forewarned of that situation now, and I just mention that for that reason.

MR. CHAMBERS: Mr. Blanchard's discussion has raised the matter, not on this particular point, I mean as to who is to pay these fees, but the general matter that has been of some concern of mine, and I think of everybody else. This hearing, as we all know, is breaking new ground with complications to say the very least, and, speaking for myself, and I think others are in the same position, and our ideas become crystallized as times goes on in the discussion, and I suggest it is impossible for anyone giving or anyone interested to give or come in and lay down probably a final concrete offer or proposition.

Now, it has just occurred to me, and I am saying it without having discussed it with anybody, that as this hearing draws to an end, probably after argument, the Board's ideas as to principles, fundamental principles as to this set-up, will become crystallized, and they may or may not be similar to all of us who are involved, but it does seem to me when the Board's fundamental principles as to what is to be done, as to where the charges are to fall is given, the matter of practical operations, there should be some consultation as to how the thing can be put together in the final analysis.

Now that is the problem that we are up against, and I am suggesting, or may suggest to a certain extent, speaking as I did the other day, that this was an offer and that I was not prepared at the moment to change it. I would welcome the views of other counsel on that point.

MR. BLANCHARD: Possibly I should not have raised the question at this point, but it just occurred to me arising out of the question at the moment.

THE CHAIRMAN: I had hoped to have had the hearing of this evidence in its proper place on the Agenda, and it would have been under Item 12.

MR. BLANCHARD: Well we have been jumping from one place to another just to suit the convenience of counsel, and the witnesses.

THE CHAIRMAN: That is right. It did occur to me that under Item 12 we would in some measure have our ideas along the lines that we have been discussing.

MR.BLANCHARD: It is something that seems to me to be very important because this proposal which is contained in the Royalite's submission filed the other day, was expressed by Mr. Mercer to be a take it or leave it proposal. Now, I am not at the moment saying where the burden should lie, but I simply say that it seems to me that in case that burden does not lie on the consumer, then let us be told now that in that event Royalite will withdraw that proposal and that the producers will not accept it, and let us then be prepared to explore alternative proposals to deal with it. It is the most important evidence of the hearing.

MR. McDONALD: I might point out, Mr. Chairman, that I have been in the course of the preparation of a submission along that in regard to repressuring in all its phases, and the reason it has not been submitted before this is that it is not, the material on which the information which we require to base a reasonable apprehension of the factors with regard to that have not yet been before the Board. The B.A. costs, for instance, are not in yet, and that type of thing. I do expect that possibly the first of October we will have a submission ready which will attempt at least to bear all the essen-

tials and all the factors involved with regard to repressuring from start to finish, and then give the views also of the producers.

MR. HARVIE: Mr. Chairman, it seems to me that we are really coming to the point now where the question was raised in the early part of the hearing that it should be crystallized to a greater extent. As I understand, the procedure suggested for carrying on this hearing was for each of the parties interested to make a submission on these branches. As far as our company is concerned, we have made a submission, or are in the course of making it, and filed it. As far as the Royalite Company is concerned, it has, Madison and Royalite.

(Go to page 2909)

And included in their submission is an offer which, be it fair or be it otherwise, is a solution to the problem. Now then there are only three people that can possibly be charged with those costs, the producer, the utility company - which would mean it being passed on to one of the other two - or the consumer. Now the Royalite submission on this particular point is that the consumer should pay that cost. It is a practical solution. As to its fairness, that is something for the Board to decide. But I do suggest this that if the consumer does not come in with any alternative scheme that they must be saddled with the costs. There is no evidence before the Board to do anything else. We have asked all along if the City, as the consumer, was going to make any submission and that has been passed on and passed on. I think this is possibly the time we should know and that I think would answer Mr. Blanchard's difficulty in part.

MR. CHAMBERS: I would like to associate myself with the last remark of Mr. Harvie.

MR. HARVIE: Mr. McDonald apparently is making a submission so far as the other of the three parties is concerned, that is the producer.

MR. CHAMBERS: That the consumer either through the Gas Company or as represented by the City is one party who is talked about here a lot as being vitally interested and the one party who has made no constructive suggestion of any kind.

MR. BLANCHARD: I suppose I am only taking up the time of Mr. Baker here and perhaps I had better go on. That is a problem we have to face.

THE CHAIRMAN: There is just one thing I want to ask Mr. Chambers. The words used were not Mr. Mercer's words,

they were Mr. Blanchard's words "take it or leave it offer".

MR. CHAMBERS: I do not think those were Mr. Mercer's words.

THE CHAIRMAn: No, I say those were Mr. Blanchard's words. Then I got the impression that you rather concurred.

MR. CHAMBERS: No, I said that so far as my present instructions are - what I intended to convey was my present instructions were that that is all I had to offer. That is in effect what I said. But as counsel appearing before this Commission, for the people I represent, I would say this when the time comes that the whole picture is unfolded I certainly am prepared to go back to the Board of Directors of my clients and say "now there is a new situation to be considered" and in what respect it could be altered if at all. I do not feel in a position to come back until I get the whole picture.

THE CHAIRMAN: The result of that might be to modify and even perhaps destroy the evidence that Mr. Baker is now giving. That might happen.

MR. CHAMBERS: Not necessarily, because I take it Mr. Baker says the 8 per cent rate is fair, assuming these other things are paid.

MR. BLANCHARD: Yes.

MR. CHAMBERS: By someone. I take it that while he uses the word "consumer" he means by somebody other than Royalite as the banker. As the banker.

MR. BLANCHARD: Well I am sorry to interrupt the proceedings in that way but as I say that occurred to me at this moment.

Q Well, Mr. Baker, you recommend as a fair discount rate 8 per cent on the monies invested by Royalite for repressured gas.

A What is that?

Q I say you recommend as a fair discount rate 8 per cent on the monies invested by Royalite for repressured gas.

A That is right.

Q And that is 8 per cent gross. It is not 8 per cent plus income tax.

A It is 8 per cent net to the company.

Q Well the proposal of the company is that they will discount at 8 per cent and pay their income tax, that is when they realize their profit on that which is the interest when they sell the gas. That they will pay their own income tax, leaving them with a net 4.8 per cent. That is the evidence of their accountant. Did you know that?

A I did not know that, sir, no.

Q All right. Their proposal therefore is that they will be content on the money invested in the purchase of repressured gas with 4.8 per cent. You did not know that?

A I did not figure it to that extent, no. As long as they got 8 per cent net that is as far as I went.

Q All right. Now to go on to Exhibit 106 and dealing first with the definition which is found in the Northwestern Utilities case in 1929. What was the corporation income tax at that time, in 1929, when that decision was made?

A I do not know.

Q Well would you quarrel with me if I told you that it was 8 per cent?

A No.

Q 8 per cent. It is now 40 per cent.

A That is right, basic.

Q That is basis, yes. It might be under the Excess Profits Tax increased to 100 per cent. At present the Exeess Profits Tax is 22 per cent and the basic is 18, that is correct?

D. Tabor.
Cross-Ex. M. Ja. Sherwood.

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Q I was just trying to see if that document is a true and correct copy of the document signed by Bowen in Toronto last night.

A That is right.

Q And that is a true and correct copy. It is not a copy of an income tax.

A It is a copy of the document.

Q You too received at the company in that form, did you, that is the copy and you treated it as your income tax, getting insurance, didn't you? That document is the instrument on which you based the insurance. Did you not? Yes or no?

A I don't know what that is.

Q All right. Your position is, sir, that you never filed an income tax return in the country since you left the country in 1950? A I never filed an income tax in the country since I left the country.

Q Did you file an income tax in the United States? A I did not file an income tax in the United States.

Q Did you file an income tax in Canada? A I did not file an income tax in Canada.

Q Did you file an income tax in any other country? A I did not file an income tax in any other country.

Q Did you file an income tax in any other country since you left the country in 1950? A I did not file an income tax in any other country since I left the country in 1950.

Q Did you file an income tax in any other country since you left the country in 1950? A I did not file an income tax in any other country since I left the country in 1950.

A Yes.

Q So that there is a tremendous difference in corporate taxation as between 1929 and today, that is right?

A Yes.

Q Now then suppose that this Excess Profits Tax, instead of being 22 per cent as it is today were to rise to 50 per cent or 60 per cent, would expect the consumer to be able to pay it in his price for the gas he uses?

A Well, who is the consumer? He is the public.

Q Yes, myself among others.

A Well the public are interested in the other angle too. You cannot exactly rob Peter to pay Paul. Somebody has to pay it.

Q Of course. And the individual consumer today is paying very high war taxes.

A Yes.

Q He is bearing some burden, eh?

A I will say so.

Q So don't you think the shareholders of the company should bear some of the burden too?

A The shareholders?

Q Yes.

A They do.

Q They do not if their income tax is paid for them.

A Well I am afraid, Mr. Blanchard, you are getting into a tax problem that I do not know anything about.

Q But it is not a difficult one to understand is it? What you are asking is that the consumer pays his high war taxes and he also pay the high war taxes of the corporation from whom he buys the gas. That is the simple si~~tuation as you~~ recommend it. That is true, is it not? I mean you do not have to be a tax expert to understand that. Even I understand it. That is

correct is it? All right, well we perhaps do not need to discuss that. So we do have this to go on basically, that the corporate tax was 8 per cent in 1929 and now it is 40 per cent and the income tax of individuals has risen in like manner, possibly more. Are you aware of the fact that in these decisions in the United States, in the Supreme Court of the United States, that in public utility cases the Courts have held and the Federal Power Commission has held, that the corporation, the public utility bear a part of these abnormal war taxes out of their returns. Were you aware of that?

A I am aware of that situation having gone on long before the abnormal war taxes.

Q That is that the utility did not get its return free of income tax, is that what you mean?

A It never has had it free of income tax.

Q Well that is what you are asking for here.

A I do not agree, sir.

Q Why? What are you asking?

A Because they are not getting it, in my opinion they are not getting it free of income tax at all.

Q You ask for a rate of return of 9½ per cent free of income tax.

A No.

Q What are you asking for.

A That is the net after the taxes that is equivalent to the average rate earned by a similar company, net after taxes.

Q I see what you mean. Well in other words instead of saying 9½, we will say 15-5/8ths return, that is the consumer will.- or 15-5/6ths per cent.

A What figure is that?

Q That is 9½ per cent, plus 40%.

A I see.

Q Is that what your understanding is?

A The 9.04 figure I referred to in this submission is after all taxes by the average industrial and commercial company in Canada. If that comes to 15-5/6ths or whatever you say then it does but that 9.04 is net, sir, I can assure you of that.

Q All right. So take your 9½ per cent basis, that is your rate of return net to Madison?

A Yes.

Q That means that the persons, the people who buy gas have to buy gas at a rate per thousand feet that will return to the company 15-5/6ths per cent rate of return, did you relaize that?

A No I did not figure it that way. I am figuring it on the average earning capacity of the average Canadian company and there are figures to prove that after all taxes, 40 per cent or otherwise, the average earnings for all these companies is 9.04 per cent.

Q Well then, who is going to pay the taxes in this way, in Madison's case? Who really pays the taxes? The company, but it collects it from the persons who buy the gas. That is the situation. I do not think we need argue that. Now then you say that you submit that a return of not less than 9½ per cent is just and equitable all circumstances considered. Then you outline those circumstances and you say "the investment is made and has to remain for the life of the project". That is one of the circumstances. That is on page 1 of your Madison submission.

A That is right, sir.

Q Now is that not true, - do you mean investments in properties or investments in shares there?

A I mean investments in money.

Q You mean the investment actually in structures?

A No, I mean the use of money, money employed.

Q So you mean the money employed in the business, that is in properties?

A That is right.

Q And that has to remain for the life of the project?

A That is right.

Q And is that any different from the Canadian Pacific Railway Company?

A Oh yes, a great deal.

Q How?

A Well the Canadian Pacific Railway Company has control of its own money.

Q In what way?

A They can use it any way they like.

Q Subject to the Board of Railway Commissioners?

A Yes, quite true.

Q Quite true, just as this Company is subject to another Board?

A Well only, as I understand it, subject to the Board of Railway Commissioners as to operations.

Q And rates?

A How about capital?

Q And rates?

A How about the disposition of capital?

Q All right, they have some money invested in certain assets such as lines and cars and so on?

A Yes.

Q And Madison has it invested in gathering lines and other structures for the delivery of gas?

A Yes.

Q Now in what respect is there any difference, so far as the investment remaining for the life of the project is concerned, where is the difference between the two?

A Because I do not believe that the working capital of the Canadian Pacific Railway Company is frozen or any part of it, due to the fact that the Board of Railway Commissioners may have control. They can divert their capital to any project they see fit, they can put it into a steamship business if it is better paying than the transportation business, if it was they would probably put in more money.

Q But they can never abandon their original undertaking, and that is the railroad?

A It is not necessarily entirely a railroad, the Canadian Pacific Railway is interested in all sorts of things.

Q Very true, but their money is frozen in these things that they are operating?

A I mean, I am sorry, sir, but I cannot agree with you, I cannot liken this situation to the Canadian Pacific Railway in any manner whatsoever.

Q All right now.....

Q TO THE CHAIRMAN: Mr. Baker, you are not suggesting that this Board has any right to tell Royalite or Madison what it shall do with its funds other than those which are invested in the structures and an amount for working capital?

A That is all.

Q Surely we have no power to control Madison beyond that?

A No sir, only that portion which this business may effect

and that represents, as I understand it, a stated number of dollars and that is all my argument here is intended to deal with, there is a stated number of dollars involved, is that not right?

Q That is right?

A And that is all I am dealing with.

Q But supposing they raise another million dollars, supposing they raise another million collars and wanted to go into some other type of business with that money, we have no control over that?

A I would not think so.

Q No, I would not think so either, and that is Mr. Blanchard's point, - where is the difference between this company and the Canadian Pacific Railway Company as to its railway, as to its transportation system, it is subject to the control of the Board of Railway Commissioners.

A Well is the Board of Railway Commissioners taking away the property earnings or are they free to control any part of the Canadian Pacific Railway capital or assets, - they control operations.

Q MR.BLANCHARD: And rates?

A Franchise.

Q Rates?

A Franchise.

Q What they can charge for freight?

A Well I may be stupid, sir, but I cannot agree with you.

Q All right. Then, as the Chairman has said, what is to prevent Madison inviting more capital to come in for some other purpose, there is nothing to prevent them from doing that?

MR. CHAMBERS: Will you let me interrupt, I do not

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agree with that premise entirely, I suggest Madison is a public utility company and as such cannot sell shares without the Board's consent.

THE CHAIRMAN: Even for some other project?

MR. CHAMBERS: I think not.

THE CHAIRMAN: Supposing they wanted to go into the transportation business on the Bow River.

MR. CHAMBERS: The way the Act is worded I do not think so.

THE CHAIRMAN: Could they not raise money to do that?

MR. CHAMBERS: We would have to get your consent, I suggest.

THE CHAIRMAN: If they want to raise money for purposes of an utility they have to come to me, but I think their corporate powers would give them something beyond that, which I cannot control, if they wanted to enter into another venture. I am not being dogmatic about that.

MR. CHAMBERS: No, I understand.

Q MR. BLANCHARD: I suppose as long as the money invested in this gas business pays a fair rate of return, there would be no reason why they should take their funds out and invest them in something else as long as they were getting a comparable rate of return, comparable with that of other companies.

A What money is that you refer to?

Q The money which is invested in their capital assets?

A The money which is invested in Madison, are you speaking of that?

Q Yes?

A Well as I understand it, they do take it out when they can, by a depreciation account, they take it out and then you are

through, the Board if through.

Q And that money can be used for other purposes?

A It can be used to earn the going industrial average rate.

Q Yes?

A Yes, but not until they get it, it is frozen until they get it.

Q Yes, but they are getting it annually?

A Yes, that is right.

Q There is a constant flow back to them of the capital they have invested?

A That is right.

Q And in the interval they are getting a rate of return on that capital?

A That is right.

Q And we are trying to find out what is fair?

A Yes.

Q In the matter of rates?

A Yes.

Q Now how did you happen to fix on the 9½% rate, is that your figure or is that a figure which Madison said they intended to claim and asked you whether it was reasonable?

A Well the Madison Company asked me if I would give this evidence and I said that I did not know a thing about the oil business or the gas business, or had anything to do with it. They asked me if I would talk to them about it and I said "Yes". They did not mention any rates and I mentioned the rate, having read of some similar cases in the States, and I made the statement that if those rates had been agreed to by the Supreme Court of the United States, that there would be a comparable rate for Canada, and it might be 10%. In the

meantime they gave me the report of the Valley Pipe Line, is it not, the oil line, and also a report on the inquiry into that, that is Judge McGillivray's Report, and then the findings of the Court of Inquiry into that Report some years later, and I read those two reports. In the meantime I got some information, as you will see, from the Bank of Canada and the United States and the result of that is precisely the argument you have in front of you, but there was no suggestion made whatsoever to me at the start of this whole thing.

Q Yes. Now what risk, what risk is there in the Madison business that you do not find in other businesses of the 600 odd companies which you extracted from the Bank of Canada report, we are speaking of hazards and risks?

A Well I can merely cite the extent of those by saying personally I do not know.

Q What?

A I do not know the type of risk or the hazard involved so naturally I discussed it with not only the engineers here in Calgary but we have to have a consulting engineer of our own and I went into that very fully with him and he stated to me, I not being an engineer, he showed the type of risk as it was and we compared several other situations that I knew a little more about.

Q Yes. Well can you tell me what kind of companies these six hundred and seventy-eight companies are that are referred to on page 11 of the Bank of Canada report, what kind of companies are they?

A Well they would not be the smaller ones. They would be the medium sized ones. The smaller ones, they do not get proper figures on, that is the very small ones. They would be the lower medium and larger companies and it would be a cross-section of all industry.

Q Mining companies?

A I would imagine so.

Q They would be included?

A I imagine they might be included.

Q Gold mining companies?

A Now in this.....

Q Just answer that, do you know whether gold mining companies are included in the six hundred?

A I do not know.

Q What?

A I do not know.

Q You do not know?

A What?

Q I say you do not know?

A No, I do not know.

Q Well, I suggest to you if they are mining companies, that there are certain hazards in mining, are there not?

A I would think so.

Q What are the hazards?

A Well there are plenty of hazards, you might run out of ore is one.

Q You run out of your vein is one hazard, that is one hazard, and what are the others in a gold mining company?

A I am not a mining engineer and I do not know, Mr. Blanchard.

Q You have some idea. You advise people on investments?

A Yes.

Q They come to you and say "Do you think that God's Lake is a good investment or some other one?

A In that case, if I had not been on the property, we have a consulting engineer advising our investment staff, we do not

advise on God's Lake, we send the engineer there and he advises us.

Q All right, but in mining there are certain hazards?

A Yes.

Q There are hazards that the price of gold will go down, that is one hazard is it not, is that such a distant prospect?

A Well I cannot answer that. Who knows whether the gold price is going down?

Q But it is a hazard, is it not?

A I do not think it is a hazard, no.

Q All right. It is a hazard that you may lose the vein though?

A Yes.

Q Yes, that is a hazard, and then you are through, are you not, in a gold mine?

A No, because you may pick up another one.

Q Oh, I see, you may pick up another vein?

A Yes.

Q And invest some more money to do so?

A No, you may have the money in the till.

Q All right. Now then, what about industry, take - I assume that a large number of these 687 or 678 companies are industrial?

A They would have to be.

Q And have you any idea how many of them have been engaged in the production of materials for war?

A No.

Q Do you think that the high production due to war industries has anything to do with the returns shown on page 11 of this Bank of Canada statement?

A No, I cannot believe that, sir, because there were war taxes to offset that.

Q This is net?

A Well I know it is net, but at the same time you have, most of those contracts were on a cost-plus basis, or most of them.

Q Now do you know, or does anybody know what is going to happen to the contracts of these companies through reconversion, going back to civilian production, does anyone know that at the present moment?

A Well I can only use my imagination.

(Go to page 2924)

Q Well is there any hazard in your mind or risk dependent upon buying common stock in a great many of these Companies at the present time ?

A Well those Companies that are followed closely, a lot of difficulties of that sort have been foreseen, plans have been made.

Q You mean they have created a reserve against a period of more earnings. Do you mean that ?

A No I do not think they have been able to do that.

Q Have they been able to do that ?

A I do not know of any Company that can create much of a reserve except in plant assets. How can they create a reserve in one hundred percent excess profits tax.

Q Do you find anything in your statement you have put in to indicate a reserve,undistributed profits ?

A A normal reserve, yes.

Q Now what assurance is there that this high earning capacity is going to continue now that the war is at an end,with all these Companies. Do you believe it is to be continuously without a drop at all ?

A Well I will answer that question in this way. I do not know just why my guess is any better than yours or anybodys.

Q Then we are not sure about that ?

A I do know this that if the national income is not maintained at a far higher level than it was prior to the war this country is going to be a flop.

Q Well all right. Now are you absolutely positive about the position of what is going to happen in the earnings of all these Companies ?

A No.

Q The cross section, neither am I so there is a hazard there.

[illegible] in their own hands. If you will [illegible] [illegible] during which time a great many of them [illegible] present time.

[illegible] those Communists already [illegible] [illegible] and freedom. Some have [illegible] [illegible] operations. [illegible] that:

No I do not think any have a [illegible] to do that.

Have they been able to [illegible]:

I do not know of any country that has [illegible] [illegible] in public assets. In the last month a [illegible] [illegible] public [illegible].

In the final analysis is your statement [illegible] [illegible] [illegible] property [illegible] [illegible].

[illegible] is done [illegible] [illegible] [illegible] to [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible].

[illegible] that [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible]

A Yes.

Q Yes there is a risk element in buying common stock. You agree with me ?

A Yes, decidedly.

Q There is the risk which may come from competition. That is correct is it not. The risk of higher wages. Those risks exist in every industrial concern or any company, unregulated company, that is correct is it not. And none of these companies are guaranteed anything in the way of a rate of return from anyone unless they are regulated. That is correct too, is it. Do you agree with me there. Do you agree with that. I think the answer is self evident.

A I think it is obvious.

Q Yes, that is obvious. Well let us go on to this statement on Page 11, you have it before you, have you. You have it before you. Now then, this net income to stock holders which is 9.04% is not the dividends they are receiving ?

A Not what ?

Q Not dividends, they do not get 9.04% in dividends ?

A No.

Q Looking at your statement, can you tell me what the average dividend is that the stock holders are receiving ?

A No.

Q Can you work that out. It works out to 6.1%. Would you be surprised to know that ?

A The average dividend ?

Q Yes.

A Of those 678 Companies ?

Q Yes.

A No.

Judge .. Hunt.
Cross-exam. by Mr. Lambert.

- cont -

- Yes.

. The chart is a plus 1 not in right common stock. ...
...ion me.

- I'm doubtedly.

- Where is the line which may come from competition. ...
correct is it not. The high or highest ... ...
exist in every industrial concern or in company. ...
company, that is correct in it not. And now ... there ...
are authorized activities in the way of ... of return ...
unless they are ... That is correct too, is ...
... with me there. ... with it. ...
... is still without.

- I think it is ...

Q. Well, it involves. I'll let ... in this ...
Here it. You ... it before ... I've ... You ...
... Now the ... this not income to stock holders which is
in not the ... dividends they ... receiving ...
... ?

- Yes, they do not ... in ...

...

...

Q Well all right. I have not a slide rule, but I think it is 6.1%. Now then, do you know when if ever the shareholders will receive the undistributed income ?

A No.

Q There is a risk there is there not, eh? They may never get them. That is true is it. Or it may be used to equalize dividends in bad years. That is correct is it ?

A Well the credit is building up whether they get it or not.

Q But I mean to say industry and everything else has good and bad years. There are slumps in businesses as we all know and there are the high points and a Company's earnings, reserves, may be using undistributed income to meet those bad periods. So that the only thing you can really judge the value of stock on is what a shareholder gets in dividends. That is correct is it ?

A No I do not agree with that.

Q You do not, all right. What other purpose could this undistributed income be used for by the 678 companies ?

A To create larger earning potentials and future larger dividends.

Q Have dividends ever been larger on the whole than they are now, or were last year. We are talking of 1943, I think you are taking -

A Have dividends in the aggregate ?

Q In the aggregate across the board.

A I have not the figures before me, but I believe they have been higher, yes.

Q Mr. Baker, will you tell this Court the names of half a dozen companies in which you can tell this Court that they can safely invest their money and get 9½% dividends ?

A That they can safely invest their money and get 9½%. Well I

Well, all right. I have not a slide rule, but I think it
G.L. Now then, do you know when it was the policyholders
received the undistributed income?
No.
The one is a risk that is there not, but you never
there. That is what is it. Or is it not to used to capitalize
dividends in two years. That is correct is it?
All the credit is building up whether they get it or not.
But I mean to say industry and everything else has good and
bad years. Now, is change in business so we all know
there are the risk risks and a company's earnings, reserves
may be making distributed income to meet those bad periods.
So that the only thing you can really judge the value of a
co is not a policyholder gets in dividends. That is correct
is it?
It is not exactly with that.
Now to me. It is that. Other offices could this initiative
of their [illegible] for [illegible] company.
[illegible]
In future I was dividends
[illegible]
[illegible]
[illegible]

think that is a very unfair question. Can anyone in the world tell anyone else that they can invest their money safely at 4% today.

Q That I do not know, but here we have you recommending 9½% and you say that alternative opportunities -

THE CHAIRMAN: Eliminate the word "safely" Mr. Blanchard.

MR. BLANCHARD: All right.

Q Can you tell us some Companies in which we can invest our money at 9½% ?

A I refer you to the average of 678 Companies which have succeeded in earning in their own businesses 9.04% and beyond that I do not know.

Q And they have been paying dividends of 6.1%.

THE CHAIRMAN: If I came into your office, Mr. Baker, in Winnipeg and said, I have $10,000.00, I want 9% on my money, will you please advise of the stock into which I can put my $10,000.00 and get 9% per annum ?

A No I cannot do that. In that statement of mine I am not suggesting - we are talking at cross purposes. We are not talking about the same kind of money. I am not talking about the same kind of money as you are.

Q MR. BLANCHARD: I have only one kind of money and very little of that, but I want to know where you can go outside of Madison and get 9½% for your money ?

A You ask the Madison Company.

Q Eh ?

A You ask the Madison Company if they feel confident of earning better than 9% on any working capital they have got and see what they say.

Q It is Madison only that assures you they can do better with

their money ?

A 678 Companies that assure me.

Q Which is it, Madison or 678 Companies ?

A I do not know. I ask you, you ask them and in my report I say there are 678 Companies that have done that.

Q What is that net income to stock holders based on. Do you know what those figures are based on in that balance sheet of the Bank of Canada ?

A It is based on - they arrive at what they tell you according to their own letter and in this report is the net income after all charges.

Q It is based on their books I take it ?

A It is a result of carrying out a normal business.

Q Is it based on their book values ?

A It is based on their merchandising, selling and other business ventures that they are able to do that.

Q These statements come from the records of the 678 Companies ?

A That is right.

Q And here we have given their plant,property and equipment net at $2,314,000,000.

A Million is it.

Q Billion, 678 Companies. Now is that the book value of those assets or is it something else ?

A Well I will just have to refer you to that report.

Q It must be the book value don't you think so ?

MR. HARVIE: Note #1 will give the information on that.

DR. BOOMER: Note #6.

Q MR. BLANCHARD: Reserves for depreciation and depletion have been deducted. That is concerning that item, #6. All right. But that is all based on the books of those Companies, is it not?

their money ?

A. G's Companies. Not against me.

Which is it, auditors or G's Companies ?

A. I do not know. I ask you. You ask them and in my opinion I say there are G's Companies that have done that.

Q. What is that not figures to stock holders based on. In what manner those figures are based on is that balance sheet of the Bank of Canada ?

A. It is based on - they arrive at what they tell you according to their own letter all in this report is the net income after charges.

Q. It is based on their books I take it.

A. It is a result of carrying out a normal business.

Q. Is it based on their book value ?

A. It is based on their accounting, auditing and other business ventures that they - and to do that.

Q. They state in the - and to - I gather I do G's Companies ? That is right.

A. And then - have given that - consolidated - making it - 1 million, 000, 000.

Q. Million in it.

A. Million, the Company. So, is that the book value of the - and to - in something like.

Q. Well, then have to - if you to look at it.

A. Yes, you can't - you look at it.

Q. Now, I will ask - the information on that.

A. Yes.

Q. Yes.

A. Yes, sir.

Q. Yes. Is the depreciation and the - tion - on a - Bank's books. What is also - - - it.

Q. Yes.

A. What is all among - - -

A It is taken from the Company's records certified to for income tax purposes.

Q For income tax purposes ?

A They have to have an official record of some sort.

Q There is no better record upon which the Bank of Canada can base statistics than on the records taken from the books of the Company ?

A That is right.

Q If they are honestly presented ?

A That is right.

Q That is correct ?

A That is the only place they can get them.

Q Suppose you go and double the book value of the assets and properties of these Companies. What is the results to your 9.04 earnings. It is one half, is it not ?

A Yes, if they are doubled I assume they would be, yes.

Q And the same would happen here if you were to double the book value of Madison and their installations. You would cut that rate in half, your 9½%. Suppose the year before last - suppose the year before last you had come along before Madison was ever incorporated and you had found and you had said to them that 9½% would be a fair rate because the Bank of Canada said the average earnings of 678 Companies is 9.04 and then a year later Royalite increased the value in those books of those assets by doubling them, would you still say they were entitled to 9½% or 9.04% ?

A Well taking what you say they have increased their assets figure for that purpose.

(Go to Page 2930)

[illegible]
Cross-Reference by [illegible]

- [illegible] -

1. It is true that the Government's measure [illegible] is for the [illegible] the purpose.
2. For those [illegible]
3. They have [illegible] original [illegible] of [illegible] [illegible].
4. There is no [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] the country.
5. It is right.
6. It is very [illegible] [illegible] [illegible].
7. It is right.
8. That is [illegible].
9. That is the only [illegible] [illegible] [illegible] them.
10. Suppose you [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible] [illegible]

Q MR. BLANCHARD: Well, all we need for the moment, so far as your evidence is concerned, to have this cleared, is that your 9.04 earnings is based on book values? Mustn't it be?

A It must be based on true records.

Q All right. And you then consider that a return of 9.04, not a return but earnings of 9.04% is a fair earning on book values of these companies, and that is a fair criterion of what they earn, of what any company should earn, that is right?

A Well the records show it.

Q You have proved that?

A Yes.

Q All right. I won't be through for a little while, sir.

THE CHAIRMAN: All right, we will adjourn.

(At this juncture a short adjournment was taken).

Q MR. BLANCHARD: Mr. Baker, I would like to go back to this definition on page 1 of your submission, Exhibit 106, that is the green bound volume?

A Yes sir.

Q And I am going to read from about the centre, "By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive if it were investing the same amount in other securities." Now, you mean by that if it were investing the same amount today in other securities?

A If it had the opportunity at any time is what I mean.

Q At any time?

A Yes.

Q And you are not suggesting if it had the opportunity when it

first built this property?

A It must be fixed at the time, to fix a rate as to what the opportunities are.

Q To go into other investments?

A From the moment the funds so employed become frozen.

Q Well, January 1st, 1944, it has become a public utility, we will say?

A Well then, from then on they are not enabled to utilize those funds for other purposes.

Q And in fixing the rate of return would you say that it is what they can invest in other securities at that time, what rate of return they could get by investing in something else?

A Whenever that money is in their possession.

Q All right. I just want to refer again to that page 11 of The Bank of Canada Report, and I pointed out to you that the actual dividends were 6.1% average for all these companies, and I want you to just look back for the years that are shown on the top of the page, that is 1936 to 1943, and you will agree with me that in each year the cash dividends have been substantially less than the earnings to the extent of about one-quarter, that is apparent?

A That is quite apparent.

Q Yes. Now I suppose you would agree with me, and perhaps you will and perhaps you won't, that there are two elements that you consider in an investment. There is the pure interest, that is to say, the rate that you can get by investing, let us say, in Government bonds. That is your pure interest. And then the rest of your return on capital is a premium for risk really, that is correct is it not?

A No, I would go ahead of that a bit. If a corporation has

funds to employ, they do not consider the investment in securities in a narrow sense of the word, but in a broader sense of the word. The first thing that you consider is goods and services that are to be hired and used by that money. Those funds are put to work. Now it is a choice as to the type of employment you give those funds. Having determined the type of employment you select for the utilization of those funds, you then might consider investing surpluses in a high grade bond, preferred stock or common stock. Now, you do not, nor would you have funds to do that with unless you could create earning by employing services and distribution, merchandising of some goods and products for distribution, so that I do not think that you could say that one should consider funds being employed in the investment of bonds as being related to the value of that money by employment as I have stated initially.

Q One can always invest one's money in Dominion bonds and get the current rate of interest on those bonds?

A That is right.

Q That is considered a basic investment that is perfectly safe?

A That is right. That sets the rate.

Q That sets the rate?

A Yes.

Q And then if you decide that you are going to invest in something that is going to give you a higher rate of interest, a better rate of interest than your safe investment of bonds, my suggestion to you is simply this, that that higher amount is a premium for the risk, I mean, putting into something that is a little more hazardous than the bonds.

A Well hazardous is not necessarily the word. In fact, I do not think it is the word at all. It is a question of the greatest - the greatest thing to look for in an investment

of that nature is the marketability. You would not call it a hazard.

THE CHAIRMAN: Would speculative suit you better than hazardous?

A No. Risk.

MR.BLANCHARD: Risk?

A Yes.

Q All right.

A A hazard - it doesn't imply that it is not safe as a security, as it can be just as safe.

Q Oh, it may be, but it is a premium that you get for the risk?

A That is right, for the risk of not being able to sell it.

Q Now I am just going to ask you about some of the arithmetic that you have on page 4. You compare the interest rate on Dominion of Canada bonds and United States bonds. Incidentally, are these United States bonds selling at a premium or a discount?

A At the moment they are selling at a set premium, and so are ours.

Q Both?

A Yes, it is a true comparison.

Q It is a true comparison?

A Yes.

Q Very well. You have taken as your base of a return to the gas utility in the United States at 6½%. That is at the bottom of page 3?

A That is right.

Q And then you compare at the top of page 4, you compare the interest rate on Dominion bonds which are pure interest, basic interest, in the two countries?

A Yes.

Q And you find that the rate of return on Dominion of Canada Bonds is one-third higher than that of the United States, and then you proceed to multiply your 6½% gas utility rate in the United States by that one-third?

A I start there by saying.....

Q Decrease it by a third?

A I start there.

Q Yes, I am going to follow along a little further on. Now then, I really do not understand why you do not just simply add, if you are going to adopt this method, why you do not add three-quarters of 1% to the American. The interest in Canada is, for a basic security, is three-quarters of 1% more, that is all. That is true isn't it?

A That is right, yes.

Q Why multiply it by one and a third?

A Because I wanted the sequence to carry through to give you the percentage when relating it to the utility situation. That is all. It is just two ways of doing it.

Q Well, one way would be just to add three-quarters of 1% and that would make it, add three-quarters of 1% to 6½%, would be 7.1?

A Oh no.

Q Why?

A That is not fair at all.

Q Listen, I am separating the interest you get as pure interest from the risk premium. Now then, you have chosen to compare the pure interest on United States bonds and Dominion of Canada bonds, and I cannot see for the life of me why you multiply your 6½% gas utility rate by one and a third instead of simply adding to the base rate the difference between.

A Because that is not the customary figuration in figuring yields. Your yields are figured on a percentage basis, .01 or one-tenth of 1%, and you would not get the correct answer if you were to add three-quarters to 6½ at all.

Q You would get the difference between the basic interest rate in the United States and Canada on basic securities?

A I do not agree.

Q All right, you do not agree. So you have then multiplied the difference by the 6½% there. Now then, we come along to your next arithmetic adjustment here, and you say that 8.66%, which is got by multiplying the difference between the basix interests on basic securities and you still find you are .84 below the 9½% rate. Now then, you then add 1/20th to the rate you have already got in Canada. Why do you do that?

A Because.....

Q You have already got your Canadian rate. Why are you going to add to it again?

A Because that is tying in. Naturally there would be a difference in the relationship as between federal issues in each country and the utility rates in each country. The difference of 5% over the 6.5 allowed in the States is the difference between the American industry and Canadian industry, which I think is a fair conclusion and a logical sequence.

(Go to page 2936)

Q I thought we had already got that in your first multiplication.

A I do not think we have.

Q All right. I do not understand it, I may say. Tell me, are the class of companies, the 2,665 companies referred to in Exhibit 108, are they the same class of companies as the 678 in Canada?

A That is a fair assumption.

Q It is just an assumption is it?

A Well it can only be because I have not seen them, but it is a fair assumption because if they want to get those figures accurately, if the figures mean anything they must take representative companies forming a cross-section of the whole country.

MR. CHAMBERS: Would you look at page 40? You submit some information on that.

MR. BLANCHARD: What is that?

MR. CHAMBERS: Page 40 of that same exhibit gives some indication.

MR. BLANCHARD: I am looking at that page 40. That is the list I referred to, on page 40.

Q Well, Mr. Hamilton has suggested that I ask you this, if you take the net income of the United States and Canadian companies shown in the two exhibits 107 and 108, you will find that the net income is only 1/20th higher in the United States than it is in the Dominion of Canada or in Canada it is 1/20th higher than it is in the United States. That is right?

A Yes.

Q If that is the case, why have you found it necessary to multiply the rate in the United States of 16½ by 1/3 as you have at the top of page 4?

A No, 5 per cent.

Q No, at the top of page 4 you have multiplied it by 1/3rd.

A Because the difference is 1/3 at the top of the page.

Q No, it is only the difference of 1/20th between all these companies in the United States and all these companies in Canada.

A That is right.

Q The rate is 1/20th you see.

A Yes. In one case you have a difference of 1/3 as between the bonds, is that what you mean?

Q That is what you say, yes.

A Yes. We are saying that they are 1/3 higher and in the other case the difference as between the Canadian industry at 9.04 and American industry at 8.6 is approximately 5 per cent. In the other case it is 33-1/3 per cent.

Q You want to multiply the risk premium by the difference in percentage of the basic premium.

A Because that is the only way I know how to do it.

Q You refuse just simply to add the ¾ of 1 per cent.

A I cannot stop you from doing it.

Q Now then, is this a general conclusion we can come to that you add 1/3 because the Canadian companies ought to have 1/3, should - earn 1/3 more and then you add 1/20th because they do earn that much more.

A In the one case you are entitled . . . . . The money values as between the two countries are shown by these remarks. The money conditions as between the two countries are shown by the Indices of industry so to relate them I chose that mathematical method. If there are other mathematical methods of doing it, I do not know.

Q Do you notice the income for, the net income for public

utility companies in the exhibit 108?

A Yes.

Q What is it?

A Around six something, you have it there, would you mind reading it out?

Q 6.5. 6.6 in 1943 and 6.5 in 1944. Now that is not dividends as I understand it. That is net income.

A Yes.

Q And that is compared with the 8.6 average for all companies of every description.

A That is right.

Q Now you know that Royalite stock trades on the market quite freely.

A Quite.

Q Quite freely and do you know that it is selling from 19 to 20?

A No.

Q Dollars a share.

A No, I thought it was 20 to 21.

Q Well let us say it is 20 to 21 and the public are buying and selling that stock every day.

A No, not every day.

Q Well it is what you would call a freely-dealt-in stock. It does not go begging.

A It what?

Q It does not go begging at those prices.

A Well in my language no, it is not a freely-dealt-in stock. Perhaps in yours it is.

Q Well here is a quotation from the Financial Post for September 8th, 1945. Is this a reliable publication?

A Yes, the Post publication is reliable.

Q I find there were 825 shares of Royalite dealt in during that previous week. Would that probably represent what was offered in the market?

A That is right. That is only relative. Some stocks trade 200,000 shares.

Q I find also that they were selling from $19.50 to $20.00 and that the dividend rate, per cent, on that price is 5.1 per cent. That means that the public are willing to invest in Royalite for a return of 5.1 per cent. That is correct isn't it?

A Yes.

Q Now do you know what the operations of Royalite consist of?

A No, I know it is an oil company.

Q Do you know that their oil business, for instance, is confined to Turner Valley?

A No.

Q If it is, it would be fairly isolated in its operations would you say?

A No, I cannot answer that because I do not know what the operations in Turner Valley are.

Q Well they are producing oil, natural gasoline, and through a subsidiary, natural gas for sale to consumers as fuel. Now one of their assets is that they are the only shareholder of Madison Natural Gas Company Limited. You know that?

A Yes, I know that.

Q And you bespeak for Madison Natural Gas Company a net rate of 9½ per cent where the public are prepared to buy the parent stock at 5.1 per cent. What would be your idea about the safety of that investment, 5.1 per cent.

A I do not see any relationship at all.

Q Are there any hazards in the Royalite business, do you know?

A I would think so. I have been informed by engineers there are hazards in the Royalite business, yes.

Q Do you know that the production of crude oil from Turner Valley, which is the only field in which they are operating wells, that the production will probably be exhausted in the course of say 10 years. That is crude oil. Do you know that?

A No.

Q So there is the hazard of finding other oil fields and the hazard of dry holes and the hazards attached to wildcatting. Now then, they do have one thing, one asset for which they have a market and that is natural gas, for which they have a market in Calgary and from Calgary to Lethbridge. Do you think there is any greater risk in their natural gas business, any greater hazard than there is in their other business?

A I cannot answer that.

Q Do you know that Royalite entered into an agreement with The Canadian Western Natural Gas, Light, Heat & Power Company Ltd. whereby for all time they limited the amount they could get for gas to 7¾ cents.

MR. HARVIE: What?

MR. McDONALD: No. They did not limit the price at any time.

MR. BLANCHARD: Didn't they?

MR. HARVIE: I think it was 11 or 12 or 13 cents,

MR. BLANCHARD: Well I may be wrong about that.

MR. STEER: The original contract was 13 cents and it gradually reduced until 7¾ cents is the price that is being paid now.

MR. BLANCHARD: That is the price, yes.

MR. STEER: Yes.

MR. McDONALD: That is in supplementary letters.

MR. CHAMBERS: If my learned friend is asking the witness to assume that, I am taking exception to his assumption. I certainly do not think that is the position under that agreement.

MR. BLANCHARD: Well perhaps I had better not pursue it until we can thresh out what the obligation of Royalite was before the Legislature stepped in.

Q Now then, let us take British American Oil Company. I find on page 18 of the Financial Post of September 8th, that 1581 shares of British American Oil were traded in, that is fairly free trading for stock of that kind?

A Yes.

Q And that the dividend yield at the price at which that was being sold was 3.9 per cent. The public buying that fairly freely to yield 3.9 per cent. What would you say are the hazards in that business?

A Not very great.

Q Not very great?

A No.

Q Would you say that their hazard with respect to their oil business is less than that with respect to their natural g

A British American Oil is in the merchandizing business, distributing business.

Q Yes.

A The natural gas business, the securing of gas, etc. I would think, unless you had very accurate engineering reports, I would think that it would be more hazerdous. But those are things I do not know anything about.

Q All right. Imperial Oil. I see that there were 6,481 shares traded in during the week I have mentioned and that they are

returning a dividend of 3.2 per cent. Now then having regard to that situation, why should Madison that has a monopoly at the present time at least, a monopoly of the gas business in the Southern part of the province, why should you say that a fair rate of return should be 9½ per cent?

A Because there is no relation whatsoever between earnings and dividends. What may be paid by way of dividends in one company on a percentage basis to earnings may be entirely different in another company. That is merely a decision of a Board of Directors as to whether or not they pay a dividend and to what extent they pay a dividend.

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I made a note here of that and I felt to compare net earnings of a corporation with the amount such corporation made by payment by way of dividend would only confuse any argument as to earning power, potential earning power. If in a corporation its capital is restricted to any one venture, that is one thing, but if the corporation is free under its charter to employ those funds any way they choose, those are earnings that they derive, but what they pay by way of dividend has no relation to what they earn.

Q Well I am going back to your definition:

"By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise as it would receive if it were investing the same amount in another security".

A Well my interpretation of that in a trading sense and in which we use it every day, there have been funds allotted to a certain project, those funds are invested in a certain job of work. My interpretation of that, when you say "were invested in the same amount of other securities", that is that those funds are employed in exploration or distribution or some development which is the security for those funds. Now it is not a long bow to draw there because if that were not so then this company, if it was placed in that position of having to restrict its operations, then any distinction of this sort would not apply. I do not see that you can say that that word "security" means a security such as you understand it.

Q Now the difference between Madison under regulation and these 678 companies is that all the earnings of Madison, that is all the net income of Madison represented by its rate of return fixed by this Board is distributed to its shareholders, and nothing is held back; now is there any advantage in that?

A The only thing is that the company is in liquidation so far as the actual funds employed are concerned. It is a depreciating asset.

Q All right, it is a depreciating asset but it is receiving back for re-investment so much each year?

A It is only receiving back the rate it will earn, or better, elsewhere.

Q Where can it earn better than 6.1%?

A Six hundred odd companies earned it.

Q No?

A They do.

Q They actually earned 6.1%?

A The X Company in this case, the Royalite Company decides to use X dollars for an operation which in this case happens to be Madison. Now then, constantly they know how much they can earn on that money and if they are an average concern they know they are already earning better than 9% on those funds as a business rate of return, - now those funds become wholly frozen and they are told perhaps, as you suggest, 9½%, is that not too high, I think that is your suggestion, perhaps it is.

Q Yes?

A I say "No, it is not", because they want that money back where they can earn that. Now part of those funds being there and tied down, in the meantime they are not permitted to use them elsewhere where they might conceivably earn a great deal more than I am suggesting.

Q That is just what I want to know, where are they going to earn a great deal more, if you can tell us?

A Mr. Blanchard, you have the records right in front of you.

Q No, I have no records.

A You should have, there are over six hundred companies earning better than 9%.

Q On book value?

A There are the records and you have the records right there.

Q On book values?

A You have the records right there.

Q THE CHAIRMAN: Just answer the question, Mr. Blanchard is asking you if that is on book value, and I would like to know too?

A Well all I said, Mr. Chairman, if I might ask Mr. Blanchard what he means by "book value".

Q MR.BLANCHARD: I mean the financial statement taken from the books of the company?

A You mean based on records, company records.

Q Yes, which includes the value of their capital assets as shown by their books?

A Complete company records, I would rather put it that way because the book value is a difficult term.

Q All right, the value of the capital assets and that is the basis of your 9.04%?

A That is right.

MR.BLANCHARD: I think, sir, I should perhaps put in this page of the Financial Post just now. It is being admitted as being a reliable document.

MR. CHAMBERS: What issue is that, Mr. Blanchard?

MR.BLANCHARD: September 8th, 1945.

THE CHAIRMAN: What page?

MR.BLANCHARD: Page 18.

MR.CHAMBERS: Page 18 of the Financial Post of

September 8th.

MR. BLANCHARD: September 18th, no, I am sorry,

September 8th.

PAGE 18 OF THE FINANCIAL POST
OF SEPTEMBER 8th PRODUCED AND
MARKED AS EXHIBIT 111.

MR.BLANCHARD: And I think that is all, thank you.

.....

(Go to page 2947)

CROSS-EXAMINATION BY MR. FENERTY

Q Mr. Baker, referring to the Exhibit 106, your definition, or rather, no, the Supreme Court of Canada's definition which you quote:

"Rates which, under the circumstances, would be fair to the consumer on the one hand, and which, on the other hand, would secure to the company a fair return for the capital invested."

You do appreciate, I take it, the necessity in public utility Inquiries of giving some consideration to the consumer as well as the supplier.

A That is the idea.

Q Yes, and I suggest to you that in order to carry out that principle there is necessarily an obligation imposed on the utility to secure the money it requires in the cheapest possible manner, you will agree with that, will you not?

A Oh yes.

Q Yes, in order to be fair to the public it has to get its money in the cheapest manner it can.

A Yes.

Q Now I want to discuss bond issues with you for a moment and only for a minute or two I hope, the issuing of bonds is an established and recognized method of securing money by companies engaged in business and commercial operations, is it not?

A Of a certain type.

Q Yes, and I believe we all know of many examples in recent years where companies have refinanced by retiring bonds calling for interest perhaps at 5 and 6 per cent by the sale of new bonds running from perhaps 3½, 3¼ to 4 per cent.

A That is right.

Q And we all know of instances, in view of the income tax

situation which we have encountered in recent years, where companies have been refinancing by issuing bonds and using the proceeds of the sale of those bonds to retire preference share issues.

A Yes.

Q Even at the same rate of interest.

A I have not any case in mind.

Q Well I have in mind and I thought perhaps you would be familiar with it. I have a very limited knowledge of these transactions and I have knowledge of those and I thought you would too where companies have issued bonds at the same rate that the preference shares bore.

A Oh yes, I thought you meant at the same rate as the old bonds.

Q Yes, and retired the preference shares and they did so because of the fact that the interest paid on the bonds is treated for income tax purposes as an expense of operation, do they not?

A Could be but I do not know of any special case.

Q Whereas the amounts paid for interest on preference shares are necessarily out of the amounts available for dividends and so subject to taxation before payment, that is common financing is it not?

A No, I would not say it is common.

Q Do you know as a matter of fact that there has been some consideration given by income tax department officials, questioning the reason for the issuing of bonds involving the repayment or retirement of preference shares because of that, have you ever heard of that?

A No, but it would not surprise me.

Q You see the possibility even although you do not know of it, and you do not know that that has been done quite extensively.

A No, I do not know it has been done extensively.

Q I see, all right, but you can see that result would flow from that being done; now let us take Madison as a corporate entity, standing on its own feet, with an obligation to be as fair as possible to the consumer as well as to itself and I am going to ask you to assume that there is a source from which monies will be available for bonds as well as there will be for common stocks, assuming there is such a source, I suggest to you that the fairest possible method to the consumer is for Madison to finance, to some extent at least, its requirements by a bond issue, with the result that the interest paid on those bonds will be treated as an operating expense to the company before computation of income tax, would that not be sound financing, if there was the desire to be equally fair to the consumer, what do you think of that?

A Well I cannot see it.

Q What is that?

A I cannot see an asset of that sort being bonded. I cannot see that it is a type of asset that you can mortgage or lien and make it marketable. It is not the type of asset which you could use for a mortgage.

(Go to page 2950)

Q I said assuming that there were funds available to provide ?

A I cannot assume because I do not know what you would do with the Bonds if you did issue them.

Q Let us look at it another way. The Bond holder has greater security in any Company than the holder of common shares ?

A The Bond holder.

Q The holder of the Bond has greater security than the holder of common shares in any Company ?

A He owns the Company.

Q He gets less interest because he gets greater security ?

A He owns the Company. He has a first mortgage on the property.

Q And you say then this is a hazardous undertaking, the Madison operation ?

A I have been informed it is not a very safe type of thing.

Q If it is a hazardous undertaking, is that not more reason why the bondholder should be in a better position than the common share holder. The more hazardous the more reason for having bonds instead of shares. Let us get that as a general principle. The more hazardous the undertaking I say the individual who is going to invest his money in it for any reason - we are going to have some one invest money in it - the more hazardous the undertaking the more reason why he should have bonds for security reasons than common shares ?

A I do not follow that.

Q If there is danger of the bond holder getting his money back is it not a better position to have bonds ?

A Well you have got to foreclose.

Q Let us put it this way.

MR. CHAMBERS: I do not think he has finished. Let him answer the question.

[illegible]

[illegible]

[illegible]

- [illegible] -

[illegible]

[illegible] - [illegible] - [illegible] - [

Q MR. FENERTY: All right. He would have to foreclose and the common shareholder would have to wind up ?

A Yes.

Q And if there is not enough money to go around is not the bond holder in the best place ?

A No on your argument I cannot agree. In the first place are you talking about the Madison Company now ?

Q I am talking about any undertaking that is hazardous where there may not be enough money to go around, is not the bond holder in the best place ?

A Not necessarily.

Q Not necessarily, I see.

A First of all the bond has got to be issued. First of all a bond has to be issued. The covenant has to be drawn up. The property has to be secured. Well then if it is the type of asset that is not suited to a bond issue there would be no difference in value as between buying a bond and buying common stock.

Q And you say public utilities securities are not suitable for bond issues, do you ?

A No I do not.

Q You think they are not ?

A I said, I do not think that.

Q That they are suitable ?

A I think in most cases are suited, well suited, to it.

Q You say they are suitable for issue of bonds ?

A Please repeat your question.

Q Is it your opinion that public utility operations are not a suitable subject matter for bond issue ?

A No it is not my opinion.

Q That is all you can give me, I see. Do you know whether public

utility operations are financed by bond issues on any occasion ?

A I am not hearing you.

Q Do you know whether public utility operations are financed on occasions through a bond issue or partially financed ?

A A great many of them.

Q A great many of them are ?

A Yes, a great many of them.

Q But you do not think it is a suitable type of financing ?

MR. HARVIE: No, he thinks it is suitable.

MR. FENERTY: I am sorry.

CROSS-EXAMINED BY THE BOARD:

THE CHAIRMAN: I certainly got the impression he did not think this particular public utility was suitable for a bond issue. I certainly got that impression but may I just ask a question at this point. Mr. Baker, you have answered Mr. Fenerty in a general way. I got an impression from an answer you made a little while ago and I want to clear up that impression as I might be wrong. The impression I got was you suggested that this particular public utility was not one suitable for a bond issue as a method of financing. Was I right in getting that impression ?

A No you were not. I am not talking about any public utility. I think perhaps I had better explain what I have tried to convey. The money I am speaking of is not a public utility fund. It belongs to the Madison Company. The money that I speak of. That is not public utility money at all.

THE CHAIRMAN: Well yes.

A Why is it, Mr. Chairman ?

Q The Madison Company is a public utility. There is no doubt about that ?

[illegible]

[illegible]

[illegible]

A Yes, but as I understand it this whole discussion here today, at least that is the premise on which these submissions were made by me that the Madison Company is to satisfy its shareholder, the Royalite Company, by return of the fund that was deposited with them for certain operations and the rate that you gentlemen are trying to determine is what is a fair rate of return on that money that was employed by Royalite through the agency of the Madison Company. Now if you ask me if those funds should have been set up by a bond issue I say no and all the cross-examining in the world will not suggest to me that that money, those funds on deposit for this operation by the Madison Company are related to the ordinary function of the public utility company.

Q Well, Mr. Baker, let us try and get this clear. The Madison Company is the owner of a water plant, a steam plant and an electric power plant. It has compression machinery, pipe lines, lands and buildings. It gets gas from a field that we believe to have a life of at least 25 years. It has an immediate market for its gas in the field where the gas is produced. With those facts, let us assume that Royalite is going to give Madison a million dollars for this property and take some form of security. Would it not be quite proper for Royalite to take Bonds to the extent of one half of the money it would put up and common stock for the balance ?

A Well Mr. Chairman it might be quite proper -

Q Would it be security.

A I would not think so. We would not do it, we would prefer common stock issue but you get different opinions on that, but we happen to be more common stock minded in an industry of that sort because uppermost in onds mind when you issue a bond issue

on an asset of that sort what would you do in the event of foreclosure. Where is your market in an operation of that sort having to shut down. Where is your market to satisfy the bond holders one hundred cents on the dollar. You are not faced with that problem by common stock ownership, so we say as dealers, if we were asked would we recommend that sort of thing at the time we would say no. Our recommendation would be common stock ownership and that has been so with other operations that might not be considered entirely different from this one.

DR. BOOMER: Would you apply that to all public utilities?

A No I would not apply that to all public utilities but there are public utilities and public utilities.

THE CHAIRMAN: Well what is the difference between a public utility that is in the distribution business and a public utility that is in the production business as I think I know of bond issues in public utilities that are in the distribution business.

A Well also, Mr. Chairman, you know a great deal more about that field than I do. But I have been told by the engineers that I have talked to that there are certain differences of opinion as to the life of the field and some say it is very very long and some say it is very short.

Q DR. BOOMER: Were they those engineers that were here as witnesses ?

A I asked my own engineers and I know something about the history of the thing, but nevertheless you have got one market and you have got a fuel that I do not know that you can say there is anything very permanent about it. I would hate to think that you would be satisfied that this gas is going to be used for

fifteen years and upwards. I would not like to bond it but I would take a chance on common stock but I do not think you can mortgage a thing like that, mortgage an uncertain future. We have seen things happen recently that might suggest that gas won't go on for fifteen years.

THE CHAIRMAN: I will just follow that up with one more question. Supposing Royalite instead of giving that million dollars to Madison had decided to invest in commercial securities and it went looking for and found securities that yielded 9½%. We will assume that those securities had a par value of $100.00 per share. What price per share do you think Royalite would have had to pay on the open market for those shares ?

A Did you say they had a par value of $100.00 ?

Q Assuming a par value of $100.00, yielding 9½%, and Royalite gives for that a million dollars instead of giving it to Madison to buy stock of that kind. What price would it be required to pay per share. I know there is a relativity in those things.

MR. HARVIE: A senior security.

THE CHAIRMAN: Common stock.

A Whether the shares have par value or no par value that does not make any difference. You say this particular share pays $9.50 ?

Q THE CHAIRMAN: Yes.

A And if Royalite had an opportunity to buy that in some commercial company it would depend entirely upon the company.

Q Now Mr. Baker let us talk about the Stock Exchange, what would the Royalite pay ?

A Oh well, Mr. Chairman, that is just a matter of current yield.

Q 9½% is what we are talking about.

A As I say it depends upon current yield. I won't take a second

[illegible]
[illegible]. by [illegible].
[illegible]. by [illegible].

- [illegible] -

[illegible]

[illegible]

[illegible]

if you will allow me. If the stocks in that particular classification are yielding 4½, that stock would to pay that, in that case they would have to pay $215.00 or thereabouts per share.

Q And what would that represent to anyone with actual money invested ?

A $4.13 per hundred.

Q In other words there is no place on the market that you know of where Royalite could take this million dollars and get 9½% as it expects to get from Madison ?

A No but there is plenty of business places in business where they can get 9½%. That is all that I am saying.

Q I am not quarrelling with you Mr. Baker, but will you tell me some of those places ?

A Why I think that should be answered by Royalite.

Q No. No, you are here Mr. Baker to help us and we want you to tell us. We are not quarrelling with you. We want your help. You say that there are places where they can get this. I want to know where they are.

A Well Mr. Chairman there are some 600 companies which are on record in this Court today. There are some 600 companies that find that they can earn better than 9% with funds in operation. Now I am not saying I want to keep away from the point, I am saying that the Royalite Company can buy bonds or common stock or securities in that sense and get 9½% because if I were to allow you to feel that I would not be here at all. We all know they cannot do it.

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Q MR. FENERTY: Speaking generally, would you agree with this suggestion, utility corporations generally are relatively less exposed to risks than other business undertakings and this protection from the normal risks of business should be evident in the ability to attract capital more cheaply than unregulated enterprises?

A Yes, I agree.

Q I am going to ask you to assume for the moment, first of all, you know now that this Madison Company we are discussing is a public utility, you know that now?

A Yes.

Q And assuming for the moment that proper allowances will be made by this Board to amortize proper capital valuations as fixed by this Board, should not bonds of such a company, with whatever is a fair rate of return also being provided, bonds of such a company be saleable at a lesser rate of interest than the ordinary commercial company? Does not that follow?

A Not on the advice I have had from an engineering point of view.

Q Well, would you put them on a par with them for rates of interest?

A No, I could not from the advice I have had.

Q So that when you told me about companies re-financing at rates of 3½ to 4%, what you have on the bond re-financing, you think it should be something more than that, do you? You think there should be perhaps a greater rate than 3½ or 4% on a bond financing, do you?

A In this case?

Q Yes?

A I say in this case you should not do it at all.

Q Having in mind that it is a public utility, with the capital

investment returned by amortization, have you got that in mind?

A I have got it all in mind, if you are still talking about the same thing.

Q Are you talking from the point of view of Royalite or Madison?

A I am talking from the point of view of Madison, that was what you are talking about?

Q You are not worrying about Royalite for the moment.

A Is not Madison a public utility company?

Q Isn't it what?

A Is not Madison a public utility company?

Q Yes?

A Is not that what you are talking about?

Q The Madison Company, yes, but you keep talking about Royalite and I was just wondering whether the voice was the voice of Jacob but the hand was the hand of Esau. You have told me generally that, speaking a little while ago, that public utilities that are regulated are a first class object for a bond issue, and I asked you to assume that this Board will protect what is a reasonable capital investment, under the regulations of this Board, under proper amortization rates; do I understand you to say that under those circumstances this company would not be a proper subject for a bond issue at all?

A I would not be interested.

Q I do not care whether you would be interested. I say would it be a proper subject?

A That is the only opinion I would give you.

Q But would it be a proper subject for somebody else who was interested?

A I would not know.

Q What?

A I would not know. I am telling you I would not recommend it.

Q If it be true that the public utility will be protected in the way that you have been told, should not it be able to get its money cheaper than an ordinary commercial business? And we have this situation that other companies are financing, re-financing at 3½, 4 and 5%, and if public utility principles are applied to this company, wouldn't it follow that it should be able to get its money at at least that rate, if proper public utility principles are applied to it?

A No, not necessarily at all.

Q Just every other public utility but this one, is that it?

A No, there would be others in the same position. What is the life of this, do you know how long definitely?

Q How long what?

A Do you know how long definitely the Madison Company is going to continue to supply gas to the City of Calgary?

Q I think we are talking at cross-purposes.

A You asked me.

Q Yes?

A You asked me if I could compare this to the ordinary public utility company. Now you want me to answer that?

Q Yes?

A Well would you mind telling me how long this company is going to operate?

Q I do not know, but does not amortization take care of that?

A I beg your pardon?

Q Does not amortization take care of that? With regard to the capital investment, and the return on the capital, that is all taken care of?

A But does it. Does it take care of the bond issue?

Q You do not understand that.

A. Does it take care of the bond issue that you are talking about?

Q Does it what?

A. Does it take care of the bond issue that you are talking about?

Q You understand I am just an amateur in this, and I am trying to get this thing while I am talking to you. I am not trying to tell you what the proper thing is, I am trying to find out. Do I get the distinction, you say that it is not a proper subject matter for the bond issue because it is a one-shop venture with a limited life, is that your basis? The basis of your evidence?

A That is a partial reason, and a very important reason.

Q And assuming then that provision is made by orders of the Board for the retirement of your bonds and the amortization of your investment not covered by moneys derived from bonds, is there any reason why that money should not be obtained relatively cheaply as compared with a bond issue of a commercial corporation that is not so protected?

A I do not see how you could set up amortization in one year, two years, three years or four years.

Q All right.

A You say, setting up amortization. That is over a period of the life and the maturity of the bonds.

Q I am asking you to assume that the return of money invested whether on bonds or on capital investment, is protected by reason of the orders madeby this Board, are your objections to a bond issue then removed, that is what I want to know?

A All things considered I would not recommend a situation

of this sort for a mortgage bond issue.

Q No, I did not expect you would recommend it, but I am trying to find out what is wrong with it?

A Well I told you.

Q But what is it?

A Well I told you in the first place.

Q Just tell me once more?

A Because I have not yet been able to find out definitely how long this operation is going to last.

Q I see. And are you concerned if the capital invested is returned?

A I am very concerned when I have to fix a covenant to suit a bond issue when those bonds are going to mature, because if the life of this property is only five years, then I do not want to run into foreclosure proceedings and try to sell that property to somebody who does not want it. That is Number 1. The other thing is that there is nothing to suggest that something else might not take the place of gas. As a matter of fact there is a lot of interest in that at the present time.

Q Just on that. What would you say the difference in interest rates is on short term securities and long term securities? How do they compare win rates, tell me that?

A Are you speaking of short date securities?

Q Yes?

A Dominion securities?

Q Any kind. Are they higher?

A The one is about 1-5/8 and 1-7/8 and the others are 3 and 3-1/8.

Q Would that be true relatively with other things if they had short term securities?

A No, you do not have that.

Q You do not have that?

A No.

Q Would you expect that it should be a higher interest rate on bonds which necessarily would be retired in ten years as compared with 20 years?

A Would you repeat that?

Q I say, would you expect that there should be a higher interest rate on bonds for say five or ten years as distinguished from bonds due in 20 years, which would be the higher rate of interest?

A The bonds at 20 years.

Q Would be the higher rate of interest?

A As they get shorter the interest is less.

Q So that your objection to the short term does not seem to have much weight, does it, it should have less interest.

A Well may I make an explanation of that?

Q Well I am going to leave it.

A You spoke of bonds. What happens to those bonds? First of all it is the question of marketability, it is a question whether or not they are collateral, good collateral value, who holds these bonds that you are speaking of, and are they distributed to the public, and, if so, are they marketable. It is only fair to allow me to say that when you ask me if I think a short term bond is better than a long term bond or vice versa. It depends on the bond. It depends what the bond is on. It depend s what you are trying to do. So that when you ask me a question and ask me to answer it yes or no, it is not fair. All you are getting is a half truth. That is all you get.

Q Now I am going to hurry along, and just ask you one more

thing. Would you analyze for me the results of Madison financing through issue of shares and financing in part through the issue of bonds, assuming we could get funds by the issue of bonds, you will have to assume that, and I just want to run this down with you. In the first place, you say that Madison is entitled to a return of 9 or 9½, some figure you feel after the payment of income tax, which I understand may run to 15 or 16%. Now we are in agreement, aren't we, that as far as we know at the moment and hope for the future that if Madison finances in part with bonds, whether it is 3, 4, 5 or t%, or even 9%, if you have heard of such a thing, those interest charges on those bonds will be treated for income tax purposes as an operating expense and deducted from earnings before the computation of the income tax, that is right isn't it?

A I am not a tax expert.

Q Pardon?

A I am not a tax expert.

Q Well, that is so, isn't it, in the ordinary cases?

A I believe it is. I do not know definitely about it.

Q Just a minute. That bond interest on legitimate bond issues, moneys borrowed for the operations of the business and used to earn income is treated as an expense and so deducted. We do not have to argue about that, do we?

THE CHAIRMAN: It is a question of law. It is a question of the interpretation of statutes, and we are all agreed with regard to that.

MR. HARVIE: It is a question of the Minister of Finance's discretion.

MR. CHAMBERS: And acceptable to the Minister.

Q MR. FENERTY: Can I assume that is the way that bond interest is dealt with. And assuming once more that dividends paid by a Canadian corporation to another Canadian corporation are also free of income tax, I suggest to you that the result is in that regard as distinguished from financing through a bond issue, is that the customer or the consumer necessarily pays substantially more to the Madison Company, and the Royalite Company necessarily pays substantially less income tax as a shareholder of Madison.

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MR. CHAMBERS: I do not want to interfere but I think I can admit practically all Mr. Fenerty is trying to get at now that in the ordinary course if you have a bona fide bond issue with a reasonable rate of interest, that the company's income tax bill would be less.

MR. FENERTY: All I am trying to do is to find out from an expert if that is what happens.

MR. CHAMBERS: I am prepared to admit that. That is a legitimate set-up.

MR. FENERTY: I think you should. I think it is evident.

THE CHAIRMAN: I do not know that you mean to admit Mr. Fenerty's last question. Perhaps you had better check that.

MR. CHAMBERS: All I admit is if you had, aside from the merits, if you had two kinds of set-ups, one a common stock proposition and the other part common stock and part bond issue, that the incidence of income tax would be less in the bond issue company.

Q MR. FENERTY: Would you agree with me in this that it would appear the method of financing was not necessarily the independent judgment of the Madison company, having regard to the interests of the consumer?

A Is that a question for me?

Q Yes, I say have you any opinions on that, treating the Madison Company as a separate entity from the Royalite Company?

A I have no opinion.

Q Will you agree with this that the Madison Company as a separate entity from Royalite should in order to be fair to the consumer have attempted to finance in part at least

through a bond issue.

A I do not think it is for me to answer that either.

Q I do not know. I am just asking your opinion.

A Well my opinion is that you can be fair, you can be very fair to the consumer and not necessarily give away something that you are entitled to.

Q Now one thing more, Mr. Baker. I want to turn to this report Exhibit 110. I note in the first paragraph you say: "Analagous to a bank acting in the dual capacity of purchasing agent and custodian for the consumer." Down below you talk, in the last paragraph, like this: "Royalite Company in agreeing to finance the consumer." You have made no mention anywhere in this report of the owner of the commodity have you?

A I think I have yes.

Q Now I am going to ask you . . . . .

A Yes I have, to the owner of the product.

Q Yes.

A Well I have referred here to what they pay for it to the owner.

Q No, but I am talking about the consumer.

A Yes, the bank, the Royalite Company is advancing .63 cents on behalf of the consumer.

Q All right. Now that is what I want to go into with you on behalf of the consumer and what I want to find out when you say does this on behalf of the consumer is - let me take an analogy. Let us take a manufacturing company or a mining company that for some reason produces a commodity which because it is cheaper to produce it in competition with other things or because it has overestimated the market, or for any reason it has overproduced some commodity for which there is no immediate market. He either stores that commodity or he sells it to a wholesaler and the wholesaler stores it. I suggest

to you that under normal conditions that man who produces that commodity at a time when there is no market for it, or the wholesaler who purchases it, would finance it. That is an ordinary business transaction is it not?

A Not unless the financing price is added to the cost of the article.

Q I say a man who has something to sell and has no market for it. He has got it on his hands and he finances it, does he not?

A Not necessarily.

Q Oh.

A He cannot. He cannot possibly.

Q He had better finance it or go broke.

A He cannot possibly finance it unless he adds that to the selling price of it. How could he do it and stay in business?

Q All right. The consumer pays for it in the end but I am talking about the position at the present time. He has got something on his hands.

A Yes.

Q The wholesaler buys it and in 10 years from now the ultimate consumer walks into Ashdown's Hardware store and buys it.

A Yes.

Q As I understand what you have said you say that that man who 10 years from now goes into Ashdown's store and buys it should pay for it now. That is what you have said have you not. Just think it over.

A No, I have not said that at all.

Q Haven't you?

A No, that is not even inferred.

Q The consumer, you say the consumer should pay for it now. That is the man that goes into Ashdown's and buys it in

10 years' time. How do you find him?

A Just to get back to Ashdown's for a few minutes, that is quite a common type of financing. Just what you say in this case, it does not quite work out that way.

Q Now just let us read it. "It is therefore submitted that the proposed 8 per cent discount is a fair charge for financing of this description and it is also submitted that to reimburse the company as custodians all lodgement should be borne by the consumer when the gas is initially deposited." Now the consumer, that is the man in Ashdown's is it not?

A Yes.

Q " When the gas is initially deposited." That is when the manufacturer has his product, is it not?

A The consumer is the man in Ashdown's.

Q Yes.

A Well I cannot follow you.

Q Well who do you think is the consumer of this gas?

A I say it is quite possible to finance that way, even in Ashdown's. Ashdown's goods are also financed in their own wholesale.

Q I wonder do you appreciate the fact that the information we have is that this gas which is going to be repressured may not be used for a period of some years?

A Yes I understand that.

Q And that nobody knows who is going to burn it, do you know that?

A Yes.

Q And when you talk about the consumer, that is the man who is going to use it.

A What?

Q When you talk about the consumer, you mean the man who is going to use it?

A Yes, but he cannot use it now.

Q You do not know and I do not know who is going to use it.

A That is right.

Q That is the reason I say that is the man who is in Ashdown's. And do you say what you have actually said that somebody you do not know and I do not know should pay for something that a manufacturing company has produced now because he has no market?

A He is going to get it at the same price, as I understand it, as far as the company is concerned he is going to get it at the same price in 15 years that he is today. He would not get the same articles in Ashdown's at the same price.

Q Do you agree with me that is the proposition you have put up in this blue covered book, Exhibit 110?

A I will not agree with your interpretation of it at all. What I say is in that record.

Q MR. BLANCHARD: May I just call your attention, Mr. Baker, to one thing that I notice at the bottom of this page in the National City Bank of New York, that is Exhibit 108?

A Yes.

Q You refer to the public utilities as netting 6½, 6½ per cent net earnings.

A I did?

Q I thought so.

A No. I referred to the average of that number of companies which I mentioned.

Q Yes, that is what I mean.

A Yes.

Q 215, I think, public utilities companies had net earnings of 6.5 per cent.

A No, I did not say anything about that.

MR. CHAMBERS: I think he referred to some specific one.

Q MR. BLANCHARD: Then let us refer to that. Perhaps it is only by chance that it does agree exactly.

A With that article in Time?

Q Yes. I find here on this page 40 of Exhibit 108, electrical power, gas, etc. per cent return 6.4 in 1944 and 6.5 in 1943, which is the year you were talking about.

A That is right.

Q Now then, if you look at the note at the bottom which is (a). There is a note (a) after that particular class of company and it says "in this group, due to the large proportion of capital investment in the form of funded debt, the rate of return on the total property investment would be lower than that shown on net worth only." So that my suggestion to you is that the average earnings of these public utilities companies is not, that is on the whole investment, is not reflected in that 6.4 or 6.5 per cent; that is the earnings of the equity after paying a lower rate of interest on the bonds, is that reasonable?

A That could be with that memo there.

THE CHAIRMAN: Mr. McDonald.

MR. McDONALD: Just one or two matters, sir.

MR. CHAMBERS: Might I interject. If we were going to finish today, I would go on, but if we cannot, as you know some counsel have other appointments and if we cannot finish we will have to go on tomorrow.

THE CHAIRMAN: I remember you spoke to me about that

yesterday, Mr. Chambers.

MR. CHAMBERS: If we can finish now, all right. What I have in mind is that I will take some time and maybe the Board will also. If that is so, then we will sit tomorrow or this afternoon.

THE CHAIRMAN: If we cannot finish . . . . . Well, I would like to finish.

MR. BLANCHARD: I mentioned yesterday I have to be at Turner Valley at 2 o'clock. I have finished everything I have to say. If Mr. Hamilton could be here this afternoon. I do not ask that you adjourn at one o'clock on my account.

THE CHAIRMAN: Then we have to think of another thing for the moment, Mr. Donellan. Dr. Boomer and I are prepared to sit Tuesday, Wednesday, Thursday and Friday next week if need be in order to let Mr. Donellan go home. Then I have to find out what the engagements of other counsel are for Friday.

MR. HARVIE: As a matter of fact, Friday is really no good to Mr. Donellan. He has to be in Toronto on Friday for quite an important meeting and he has a reservation back for the night of the 19th. It may be that we could possibly at least for Tuesday, Wednesday and Thursday sit mornings and afternoons.

MR. McDONALD: He has a reservation for the 19th?

MR. HARVIE: For the 20th.

THE CHAIRMAN: You will not get any transcript if we sit mornings and afternoons.

MR. HARVIE: We might at least get all his evidence-in-chief in.

THE CHAIRMAN: Well we will sit tomorrow and we will adjourn now and sit Tuesday, Wednesday and Thursday

next week.

(At this stage the Hearing was adjourned until 9.30 A.M, 13th September, 1945.)

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